APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED AND DECIDED OCTOBER 17, 2002 AS AMENDED BY ERRATA LETTER OF CIRCUIT JUDGE FRED I. PARKER DATED NOVEMBER 12, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2001

(Argued: January 7, 2002 Decided: October 17, 2002)

Docket No. 00-9419

LNC INVESTMENTS, INC. and
CHARTER NATIONAL LIFE INSURANCE COMPANY,

Plaintiffs-Appellants,

v.

NATIONAL WESTMINSTER BANK, N.J.,
FIRST FIDELITY BANK, N.A. NEW JERSEY
and UNITED JERSEY BANK,

Defendants-Appellees.

Before: JACOBS, F.I. PARKER, and SOTOMAYOR, Circuit Judges.

SOTOMAYOR, Circuit Judge:

The parties to this appeal pay our Court a second visit, following a jury verdict for defendants, who are trustees for a series of indentures. The plaintiffs, holders of those

indentures, claim that the trustees failed to exercise their powers prudently to protect the value of the collateral securing the indentures after the debtor filed for bankruptcy. The judgment now on appeal followed on remand from this Court after we vacated the results of the previous trial—also a verdict for defendants—due primarily to jury instructions which erroneously required the plaintiff bondholders to prove reliance as part of their cause of action. *See LNC Invs., Inc. v. First Fidelity Bank*, 173 F.3d 454 (2d Cir. 1999). On this trip, the plaintiffs ask this Court to decide a difficult and unsettled issue of bankruptcy law—specifically, whether a creditor whose loan is secured with collateral in the possession of the debtor and who asks the bankruptcy court either to lift the automatic stay with respect to taking possession of the collateral or to direct the debtor to provide additional "adequate protection" of that collateral, and whose motion is denied by the bankruptcy court, is nevertheless entitled (as he or she would be if the motion were granted) to an "administrative superpriority" claim for any amount by which the creditor's claim becomes unsecured by virtue of the decline in the value of the collateral. As we informed the parties on the first appeal, however, the answer to this question pressed by plaintiffs is relevant only to the issue of causation—i.e., whether, if the trustees had made a lift stay/adequate protection motion immediately upon the bankruptcy filing, the making of such a motion would have resulted in a greater recovery for the bondholders—and not to the sole issue on which the jury found for defendants—namely, whether the trustees were imprudent in not making such a motion earlier. Thus, despite the able arguments of both sides on the bankruptcy issue, we decline the invitation to decide it. Because this issue is the sole ground on which the plaintiffs have chosen to rest their appeal, we affirm.

Appendix A

BACKGROUND

The underlying facts in the dispute are laid out in detail in our prior opinion, familiarity with which is assumed. Briefly, this case arises from the events surrounding the struggles of Eastern Airlines ("Eastern") to remain viable, culminating in its filing for bankruptcy protection in 1989 and its cessation of operations in 1991. On November 15, 1986, Eastern entered into a sales/leaseback transaction involving used operating aircraft with a secured equipment trust (as far as is legally relevant here, a secured loan with the aircraft as collateral), of which defendant First Fidelity was the collateral trustee. *Id.* at 457-58. The equipment trust (the "Trust") issued three series of equipment trust certificates (the "Bonds"); defendants United Jersey Bank and National Westminster Bank (together with First Fidelity, the "Trustees"), were designated indenture trustee of the second and third series, respectively. Eastern was obligated under the terms of the trust indenture (the "Indenture") to make lease payments sufficient to cover the principal and interest payments on the Bonds as they came due. Plaintiffs LNC Investments, Inc. and Charter National Life Insurance Company (the "Bondholders") purchased second- and third-series Bonds at various times between 1989 and 1994. *Id.* at 459.

Eastern's voluntary Chapter 11 filing on March 9, 1989 not only constituted a default under the terms of the Indenture—thus triggering the Trustees' duty prudently to exercise their powers under both the Indenture and the Trust

Indenture Act ("TIA"), 15 U.S.C. § 77ooo(c)[1]—but also prevented the Trustees from taking possession of the collateral aircraft due to the automatic stay provisions of the Bankruptcy Code (the "Code"), 11 U.S.C. § 362(a). At the time of Eastern's petition, the appraised value of the collateral aircraft exceeded the outstanding principal on the Bonds (i.e., there was an "equity cushion") by approximately $228 million. *LNC*, 173 F.3d at 458. The declining fortunes of Eastern and the airline industry in general, however, caused the collateral's value to fall so that, by the time Eastern ceased operations and released the collateral to the Trustees in January 1991, there was insufficient value in the aircraft to satisfy the Bonds.

The Bondholders brought suit in the district court in October 1992, principally alleging that the Trustees had failed in their obligation to exercise prudence on behalf of the Bondholders, in violation of both the TIA and the terms of the Indenture. Specifically, plaintiffs primarily alleged that the Trustees, immediately upon Eastern's Chapter 11 filing, should have asked the bankruptcy court either to lift the automatic stay under § 362(d) of the Code or to issue an order under § 363(e) of the Code[2] that Eastern provide

1. The TIA provides that "[t]he indenture trustee shall exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c).

2. Section 363(e) provides, in relevant part, that "[n]otwithstanding any other provision of this section, at any time, (Cont'd)

"adequate protection"[3] of the collateral. The Bondholders

(Cont'd)
on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e). The "trustee" referred to in this provision is the bankruptcy trustee (if any), whose powers can be exercised (as they were in this case) by a debtor-in-possession such as Eastern. *See* 11 U.S.C. § 1107(a).

3. With regard to what may constitute "adequate protection," the Code states as follows:

> When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361.

assert that the filing of such a motion, regardless of its disposition, would have entitled the Trustees to an "administrative superpriority" claim under § 507(b) of the Code,[4] to the extent that the outstanding principal on the Bonds exceeded the value of the collateral. Such a superpriority claim would have placed the Trustees ahead of all other unsecured creditors and, as the Eastern estate was administratively solvent (or so the Bondholders claimed), this § 507(b) claim would have resulted in at least a partial recovery of the unsecured amount left owing on the Bonds. Although the Trustees did file an adequate protection motion on November 14, 1990, plaintiffs claim that this filing came too late, a result of the Trustees' allegedly imprudent failure to monitor the declining value of the collateral more frequently. *LNC*, 173 F.3d at 459.

The Trustees dispute the plaintiffs' reading of § 363(e) and § 507(b) and plaintiffs' contentions regarding the lateness of the filing. In the Trustees' view, the Code grants a § 507(b) superpriority claim only if the adequate protection motion results in the bankruptcy court's ordering of *additional* protection, and the trustees contend that the court would not

4. Section 507(b) provides that "[i]f the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection." 11 U.S.C. § 507(b).

have ordered such protection as long as there was an equity cushion. Further, the defendants claim that there was a good reason *not* to file the motion prematurely—namely, that once apprised of the fact that there was a significant equity cushion in the collateral, the bankruptcy court likely would have allowed Eastern to invade that cushion for operating capital. Defendants also claim that at the time they filed the adequate protection motion in November 1990, there was still a positive, albeit small, equity cushion, and that this fact showed that they had monitored the collateral value with due care.

The case proceeded to trial before Judge (now Chief Judge) Michael B. Mukasey in March 1998. *LNC*, 173 F.3d at 459-60. Prior to trial, Judge Mukasey had ruled—although with some reservations—that, in accordance with the plaintiffs' view of the Code, the making of a lift stay/adequate protection motion would, by itself, have resulted in a superpriority claim. When asked by the plaintiffs to so instruct the jury, however, Judge Mukasey refused plaintiffs' request and instead instructed the jury that the superpriority question "was not clearly resolved and . . . was the subject of disagreement among perfectly competent and diligent bankruptcy attorneys" and that the jury was "entitled to take this uncertainty in the law into account when [it] decide[d] whether the defendant banks acted as prudent persons in this case." *Id.* at 460. The jury returned a special verdict finding that the defendants had breached their duty of prudence, but that this breach did not proximately cause the plaintiffs' injury. *Id.*

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On appeal, we vacated and remanded for a new trial because the district court's instructions to the jury improperly required the plaintiffs to prove reliance as an element of their claims. *Id.* at 460-63. We also held that, with respect to causation, the question of the effect of making an adequate protection motion on the availability of a superpriority claim was a legal one which the district court, not the jury, should have decided. *Id.* at 468. With respect to whether the Trustees were prudent in not filing the motion earlier, however, we stated that "[i]nsofar as the jury's consideration of the unsettled state of the law was limited to the question whether the Trustees' delay in making the Motion was prudent, the charge was undoubtedly correct." *Id.* We directed the district court on remand to "therefore decide the [§ 507(b)] issue and determine what type of charge on superpriority and causation is appropriate in light of any factual disputes remaining in the new trial." *Id.*

On remand, the case was reassigned to Judge Charles S. Haight. In an opinion and order dated March 31, 2000, Judge Haight held that the Trustees' interpretation of § 507(b) of the Code was the correct one. That is, in answer to the question of whether

> a secured creditor's claim is entitled to "superpriority" status if the creditor files a motion with the bankruptcy court for an order lifting the stay of proceedings against the debtor or, in the alternative, for an order of adequate protection, the bankruptcy court denies any relief, and the creditor's collateral subsequently proves inadequate to cover its claim,

LNC Invs., Inc. v. First Fidelity Bank, 247 B.R. 38, 40 (S.D.N.Y. 2000), the district court answered in the negative and stated that it would "so instruct the jury," *id.* at 50.

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Retrial of the case began on September 11, 2000. On September 25, during a conference to discuss the jury charge, the Trustees requested that the court delete Judge Mukasey's original language describing the unsettled state of the law regarding § 507(b). The Trustees based this request on two grounds: (1) that unlike in the prior trial, there had been no evidence presented tending to demonstrate the unsettled state of the law—indeed, that the defendants had been precluded by the court from eliciting such evidence; and (2) that, more fundamentally, the state of the law was not a factual question, but a legal one—i.e., "the law is the law." (Tr. 1866). Accordingly, the Trustees requested that the jury be instructed solely that the making of a lift stay/adequate protection motion would not have resulted in a superpriority claim.

Counsel for the Bondholders objected to removal of this language, noting, among other things, this Court's approval of Judge Mukasey's charge with respect to the issue of prudence. The Bondholders argued that to fail to instruct the jury that the effect of a lift stay/adequate protection motion was uncertain at the time would be to "eliminat[e] something that [the Trustees] could have known. It is not a hindsight issue; it is a current-knowledge issue." (Tr. 1865). As the Trustees stated, this would leave the Bondholders an argument that "since it was uncertain, we should have made the motion." (Tr. 1866).

Judge Haight noted the apparent reversal of positions taken by the parties vis-à-vis the prior trial, but stated that based on this Court's prior opinion he was inclined to leave

the "unsettledness" language in the charge.[5] As Judge Haight stated, "It seem[s] to me that if what the Court of Appeals said was proper when Judge Mukasey said it, then it is still proper now on the issue of prudence. . . ." (Tr. 1862). The court, however, reserved a final ruling.

The following day, September 26, Judge Haight decided to excise the unsettledness language from the jury charge. He stated that his reason was "not so much because there was not the degree of evidence about uncertainty at this trial that there was at the first trial, although that is a part of my reasoning." Rather, he said, his ruling on the § 507(b) issue made the state of the law irrelevant:

> [H]aving held, as I have held, that the automatic making of the motion, no matter what its outcome, would have not automatically conferred superpriority status upon the claim, it follows that the uncertainty in the evidence at the first trial went to a point which would have made no difference under my 507(b) ruling, and therefore there is and cannot be, if my ruling is correct, and for the moment at least it is, no causal connection between the point at issue and the eventual outcome.

(Tr. 2072). The Bondholders noted their objection to the court's ruling.

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5. "It would seem to me that plaintiffs would like to see [the unsettledness language] out and defendants would like to see it in, but whatever the answer to that may be, I think that it is correct, in the view that the Second Circuit has taken of the world, to include that language. . . ." (Tr. 1865).

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As ultimately charged by the court, the instructions to the jury regarding the application of the prudent man standard contained no statement regarding the unsettled state of the law on superpriority claims. Rather, the charge stated, in pertinent part, the following:

> So, if the bankruptcy court grants the adequate protection motion or so orders an adequate protection motion, and that protection proves insufficient, the creditor is entitled to a superpriority claim. If the bankruptcy court denies the adequate protection motion or refuses to so order an adequate protection stipulation, the creditor is not entitled to a superpriority claim.

(Tr. 2343.)

The jury returned a special verdict finding that the Trustees had not breached their obligation of prudence and, in accordance with the instructions given, did not address any other issues. Consistent with this verdict, the district court entered judgment for the defendant Trustees on September 29, 2000. The plaintiffs' post-verdict motions for judgment as a matter of law or, in the alternative, for a new trial were denied, and this timely appeal followed.

Appendix A

DISCUSSION

On appeal, the Bondholders principally argue that the district court's charge to the jury was incorrect because it misstated the law with respect to superpriority claims under § 507(b) of the Code.[6] Specifically, the Bondholders argue that the court should have charged that the making of a lift stay/adequate protection motion by the Trustees would have resulted in a superpriority claim under § 507(b) of the Code regardless of whether the bankruptcy court granted any additional protection or denied the motion in its entirety.

As noted, the sole issue on which the jury found for the Trustees was prudence—i.e., the jury found that the Trustees had not "acted imprudently by not making a lift stay/adequate protection motion before November 14, 1990." Thus, in order to succeed on appeal, the Bondholders must demonstrate that their argument regarding the correct interpretation of § 507(b) correctly states the law that should have been charged to the jury on the issue of prudence, and that the error on the part of the district court was not harmless. *See Girden v. Sandals Int'l*, 262 F.3d 195, 203 (2d Cir. 2001).

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6. The Bondholders also challenge several of the district court's evidentiary rulings. We find none of these purported errors to be a "clear abuse of discretion" nor "so clearly prejudicial to the outcome of the trial" as to warrant a new trial. *Phillips v. Bowen*, 278 F.3d 103, 111 (2d Cir. 2002). We also find no abuse of discretion in the district court's decision not to allow the Bondholders to pursue a claim of imprudence founded on the Trustees' alleged failure to pursue an "ordinary" (i.e., non-superpriority) administrative claim in the bankruptcy court, due to the eleventh-hour raising of this theory prior to trial.

The Bondholders' argument regarding the proper charge to the jury, however, necessarily assumes an unstated, antecedent proposition. That is, the Bondholders' argument presupposes that in determining whether the Trustees' decision not to make the lift stay/adequate protection motion sooner was prudent, the hypothetical "prudent man" (against which the Trustees' conduct must be judged) must be presumed to know the "true" legal effect of such a motion—that is, as the court (today) adjudges the law. Only if we agree with the appellants on this point does the actual effect of a lift stay/adequate protection motion become relevant to our analysis.

We cannot accept this proposition, however. We made clear in our prior opinion that Judge Mukasey's original charge regarding the unsettled state of the law—i.e., that the jury was "entitled to take this uncertainty in the law into account when [it] decide[d] whether the defendant banks acted as prudent persons in this case"—was "undoubtedly correct." *LNC*, 173 F.3d at 468. Our direction to the district court to determine the superpriority question as a legal matter went solely to the issue of causation, not prudence. *See id.* ("On remand, the district court should therefore decide the [superpriority] issue and determine what type of charge on superpriority *and causation* is appropriate. . . .") (emphasis added). With regard to prudence, as indicated by our approval of Judge Mukasey's original charge, the question is not what appears to be prudent in light of our current understanding of the law, but rather what was prudent in light of what could reasonably have been known to the Trustees at the time they allegedly should have made the motion. Even if this were not now law of the case by virtue of our prior ruling, it is compelled by logic. *See Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir. 1984) (prudence of trustees must be evaluated "from the perspective of the time of the . . . decision rather than

from the vantage point of hindsight") (internal quotation marks omitted).

The Bondholders clearly understood this at trial. They objected to the Trustees' proposal to eliminate Judge Mukasey's "unsettledness" language precisely on the ground that to do so would be to invite an evaluation of the Trustees' prudence in "hindsight," rather than addressing it as a "[then-] current-knowledge issue." Yet, on this appeal, the Bondholders have not reasserted this ground for challenging the district court's instructions, even in the alternative—instead mentioning solely the § 507(b) argument discussed above. We can only assume that this choice was not inadvertent and serves as an abandonment of the argument, pressed to the district court, that the jury should have been instructed to consider the state of the law as it was known at the time in assessing the Trustees' prudence. The strategy behind such a choice is not difficult to surmise.[7] We see no good reason not to hold the Bondholders to their choice.[8]

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7. Both sides surely recognized that, because the state of the law was (and remains) uncertain, it is a close call whether the prudent trustee would have made a lift-stay/adequate protection motion sooner. Each side, therefore, had an incentive to have the law on superpriority construed in its favor and then to have the jurors instructed that the Trustees, in effect, should have known that was the law. Just as the Trustees, upon achieving a favorable ruling on the superpriority issue from the district court, had every incentive to avoid a jury charge with the unsettledness language, so too the Bondholders, arguing before this Court, had every incentive to attempt to gain a reversal on the superpriority issue and avoid the unsettledness charge.

8. While we no doubt have the power to address an argument despite its abandonment on appeal, we ordinarily will not do so "unless

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Because we reject the Bondholders' argument regarding the proper standard by which the Trustees' prudence should be judged, we need not determine whether the Bondholders are correct in their construction of the Bankruptcy Code.[9] Indeed, as is apparent from the foregoing discussion, because prudence is the sole issue on which the jury decided the case, and the correct interpretation of the Code is irrelevant to the issue of

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manifest injustice otherwise would result." *Anderson v. Branen*, 27 F.3d 29, 30 (2d Cir. 1994) (quotation marks omitted). It would be particularly unusual to do so where the abandonment appears, as it does here, to be a strategic choice rather than an inadvertent error. *Cf. United States v. Olano*, 507 U.S. 725, 733-34 (1993) (distinguishing between intentional waiver and unintentional forfeiture in determining whether appellate court may address the issue under the plain-error rule). Moreover, ignoring the waiver would result not only in the expense of a third trial, but could potentially require this Court to address the difficult § 507(b) issue (either proactively now or on a third appeal) in a context—appeal from a collateral lawsuit rather than a direct appeal from a bankruptcy proceeding—that is less than ideal for resolving such an important question.

9. We also make no determination of whether Judge Haight's charge, read as a whole, was actually erroneous. Although, as stated, Judge Haight excised the "unsettledness" language from the previous charge, he did instruct the jurors that "the prudent man standard is to be applied in light of the circumstances as they existed at the time the trustee acted or did not act." This instruction was not given specifically with respect to the state of the law, however. We express no opinion as to whether, had this point not been abandoned by the Bondholders on appeal, by this charge "the jury was misled about the correct legal standard or was otherwise inadequately informed regarding the controlling law." *Girden*, 262 F.3d at 203.

prudence, we would not need to address the parties' contentions regarding the Code in any case (except as we might have deemed it prudent to do so were we remanding for a third trial).[10]

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10. The concurrence finds it necessary to reach the § 507(b) issue because, in its view, if the district court's ruling on this point was erroneous then it improperly foreclosed the jury from finding that the Trustees' failure to make a lift stay/adequate protection motion caused the Bondholders' loss. *Post*, at **Concurrence 2-4**]. With all due respect to our concurring colleague, we do not find this argument "waived," *see post* at **Concurrence 3**], but simply disagree with it. As noted, the jury returned not a general verdict on liability but rather a special verdict on the issue of prudence only. Thus, the causation implications of the district court's § 507(b) ruling are irrelevant to this appeal unless we assume that the jury failed both to understand and to follow its instructions with respect to the distinction between the prudence and causation elements of the cause of action. The district court's instructions were quite clear on this point, and we must presume the jury to follow its instructions. *See United States v. Salameh*, 152 F.3d 88, 116 (2d Cir. 1998) (" '[J]uries are presumed to follow their instructions.' ") (alteration in original) (quoting *Zafiro v. United States*, 506 U.S. 534, 540 (1993)). As the concurrence correctly notes, if the district court were to have issued an "opposite instruction" on causation under which a lift stay/ adequate protection motion "alone could create eligibility for superpriority," *post* at **[Concurrence 3, n.1]**, and the jury were to have impermissibly elided the distinction between its prudence and causation deliberations, then "the significance of [the district court's causation] instruction on the jury's contemplation of prudence *is* obvious," *id.* (emphasis added). Our disagreement with our concurring colleague flows not from whether a jury that did not follow its instructions would have been misled but rather from a premise to that argument—whether we may presume the jury not to have followed its instructions in the first instance. The prudence issue is to be determined in light of what could reasonably have been known to the Trustees at the time they allegedly should have made the motion, not by the district court's later exposition of the law in its causation instruction, regardless of the substantive content of that instruction.

Appendix A

CONCLUSION

We have considered all of the appellants' arguments and find them to be without merit. Accordingly, the judgment of the district court is affirmed.

F.I. PARKER, *Circuit Judge*, concurring:

Although I agree with the majority's ultimate resolution of the case, I write separately to express the different basis on which I believe the district court's opinion should be affirmed. The majority proceeds from the premise that "in order to succeed on the appeal, the Bondholders must demonstrate that their argument regarding the correct interpretation of § 507(b) correctly states the law that should have been charged to the jury on the issue of prudence, and that the error on the part of the district court was not harmless." Because I do not agree that this statement correctly assesses the Bondholders' burden on appeal, I cannot join the analysis of the Court.

I.

The majority's opinion suggests that the Bondholders could only win on appeal if they showed that the district court's interpretation of § 507(b) misstated the law *on the issue of prudence.* The majority, however, misses the point. The majority implies that a "perfect" jury instruction would have combined Judge Mukasey's instruction on prudence—that the jury could consider the unsettled state of the law at the time the Trustees made their decision in determining whether the Trustees acted prudently—with a legal ruling by the district court on causation—whether a motion to lift the stay or for adequate protection would automatically create eligibility for superpriority under § 507(b) such that the Trustees' failure to make the motion inevitably harmed the Bondholders. The district court, however, instructed the jury *only* on the court's determination that a motion to lift the

stay or for automatic protection would not create automatic superpriority. In deciding not to give a further instruction on prudence, the district court noted that because its interpretation of § 507(b) prevented the jury from finding causation based on failure to make the motion alone, the unsettled nature of the law at the time of the Trustees' decision was basically irrelevant—even if the Trustees acted imprudently, their imprudence did not cause injury.

Unlike the majority that finds the appellants confined to arguing that the district court failed to instruct on the unsettled nature of law (a prudence question), I believe that based on the proceedings below, the appellants could argue (and in fact have argued) that the district court's ruling deprived them of the ability to argue that the Trustees' decision was not prudent since under the court's ruling, even if the Trustees acted imprudently, the jury could not find them liable as their actions alone could not have harmed the Bondholders—even if the Trustees had moved to lift the stay or for adequate protection, eligibility for superpriority would have remained uncertain, dependant on the district court's response to the motion. Thus, I believe that the Bondholders could succeed on appeal not only by "demonstrating that their argument regarding the correct interpretation of § 507(b) correctly states the law that should have been charged to the jury on the issue of prudence," but also by demonstrating that the district court misinterpreted § 507(b) such that it improperly deprived them of the ability to establish liability on the part of the Trustees.[1] Although the majority finds this argument

1. The majority rightfully notes that had the Trustees filed a motion to lift the stay or for adequate protection that was granted, (Cont'd)

waived by the appellants' decision to challenge explicitly only the district court's interpretation of § 507(b), I believe that any argument against the specific impact of the § 507(b) ruling on the jury's prudence and causation findings is subsumed in appellants' arguments against the trial court's interpretation of § 507(b).

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the Bondholders would have been eligible for superpriority. In this case, however, the district court instructed the jury only on the legal result of bringing a motion to lift stay or for adequate protection, i.e., that the motion alone would not create eligibility for superpriority. The significance of this instruction on the jury's contemplation of prudence is obvious when one considers the logical impact of an opposite instruction: If the court had told the jury, as the Bondholders requested, that a motion to lift stay or for adequate protection alone could create eligibility for superpriority, the Trustees' failure to make the motion would appear clearly imprudent, since the motion itself could have protected the Bondholders no matter how the bankruptcy court decided the motion. Viewed under the interpretation the Bondholders advance on appeal, the Trustees' failure to make such a motion would appear a clear decision not to take steps that would have inevitably protected the Bondholders.

The district court, however, instructed the jury that a motion would not have inevitably produced superpriority, making the Trustees' decision not to file appear less clearly imprudent. Thus, even assuming that the jury followed instructions, properly evaluating prudence and causation separately, the Bondholders may legitimately argue that the district court's instruction on its substantive interpretation of § 507(b) impacted their ability to establish liability by directing the jury's contemplation of the wisdom of the Trustees' choice not to file a motion to lift stay or for adequate protection sooner.

II.

Despite my determination that the majority misstates the "only" ground on which appellants might have succeeded in their appeal, I agree with the majority's ultimate decision to affirm the district court because I find that the appellants fail to demonstrate that the district court's interpretation of § 507(b) was in error. Finding the district court's instruction on § 507(b) superpriority correct, I conclude that any error in instructing the jury as to that superpriority was harmless.

Section 507(b) provides that a secured creditor may obtain superpriority status when the creditor allows continued use of collateral during bankruptcy in exchange for a promise of "adequate protection" that ultimately proves inadequate. *See* 11 U.S.C. § 507(b). The provision encourages creditors to "hang on" during reorganization, allowing debtors to continue to work with the resources they need to operate (and hopefully rebuild) their business enterprises. Limiting the superpriority to those creditors to whom adequate protection is granted ensures both that creditors are encouraged to take on additional risk or to withstand existing risk (i.e. when they do not have other protection like an equity cushion) in order to allow a debtor to continue operations, and that the number of creditors promised a superpriority status is limited so that post-bankruptcy suppliers will not be deterred from continued support of the business in bankruptcy by the long line of "supercreditors" behind which new claims would fall. *See Ford Motor Credit Co. v. Dobbins*, 35 F.3d 860, 867 (4th Cir. 1994); *In re James B. Downing & Co.*, 94 B.R. 515, 519 (Bankr. N.D. Ill. July 20, 1988). Additionally, several cases exploring near this issue suggest

that while a court's express finding of pre-existing adequate protection might allow a creditor to invoke § 507(b) superpriority without the grant of a motion to lift stay or for adequate protection, in the absence of such an explicit finding, superpriority is not available. *See Vincent Props., Inc. v. Five Star Partners (In re Five Star Partners, L.P.)*, 193 B.R. 603, 612 (Bankr. N.D. Ga. 1996); *In re Downing*, 94 B.R. at 520; *see also Ford Motor Credit Co.*, 35 F.3d at 867 (rejecting "opportunity" to use collateral as sufficient for § 503(b) claim); *Cheatham v. Cent. Carolina Bank & Trust Co. (In re Cheatham)*, 91 B.R. 382, 387 (E.D.N.C. 1988) (noting different result if court found, after hearing, adequate protection and denied motion on that basis).

Judge Haight's interpretation of § 507(b) also fits well the language of the statute ("If the trustee . . . provides"), 11 U.S.C. § 507(b), and the narrow construction normally afforded statutory priorities in bankruptcy law, *see Ford Motor Credit Co. v. Dobbins*, 35 F.3d 860, 867 (4th Cir. 1994); *In re Downing*, 94 B.R. 515, 519 (Bankr. N.D. Ill. 1998); *see also* 4 COLLIER ON BANKRUPTCY ¶ 507.12[1][a] (requiring that a "trustee must have affirmatively provided adequate protection to the creditor" to qualify for superpriority status).

Having concluded that Judge Haight's interpretation of § 507(b) is correct, I understand his conclusion that in light of his ruling on § 507(b), no further jury instruction on the state of the law for a prudence assessment was necessary. If a motion for lift stay/ adequate protection alone would not have entitled the Bondholders to superpriority status (the court would have had to grant the motion), the jury could

not have concluded that the failure to make such a motion caused the Bondholders to "lose" superpriority status. While the majority may be correct that the failure to instruct the jury that the law was uncertain at the time of the Trustees' decision was error, any such error is made harmless by a limited reading of § 507(b). On this basis, I would affirm the decision of the district court and thus concur in the judgment of the majority.

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AND FILED APRIL 18, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 92 Civ. 7584 (CSH)

LNC INVESTMENTS, INC. and CHARTER NATIONAL LIFE INSURANCE CO.,

Plaintiffs,

v.

FIRST FIDELITY BANK, NATIONAL ASSOCIATION, NEW JERSEY, UNITED JERSEY BANK, AND NATIONAL WESTMINSTER BANK, N.J.

Defendants.

MEMORANDUM OPINION AND ORDER

HAIGHT, Senior District Judge

Plaintiffs move for reconsideration of this Court's Memorandum Opinion and Order dated March 31, 2000 and docketed on April 3, 2000, 2000 WL 343891 (S.D.N.Y. 2000), ("the March 31 Opinion" or "the March 31 Order"), which construed § 507(b) of the Bankruptcy Code, 11 U.S.C. § 507(b). Specifically, in the March 31 Opinion I held that where a secured creditor makes a lift stay/adequate protection

motion before the bankruptcy court, the court denies any relief, and the creditor's collateral subsequently proves inadequate to cover its claim, § 507(b) does not confer superpriority status upon that claim. In the alternative, Plaintiffs move for an Order certifying the March 31 Opinion for interlocutory appeal under 28 U.S.C. § 1292(b). Defendants oppose the motion in its entirety.

I assume the reader's familiarity with this Court's March 31 Opinion and all prior opinions in this case, particularly that of the Court of Appeals, reported at 173 F.3d 454 (2d Cir. 1999), and Judge Mukasey's opinion on summary judgment, reported at 1997 WL 528283 (S.D.N.Y. August 27, 1997). For the reasons that follow, I adhere to the holding expressed in the March 31 Opinion, and certify the accompanying March 31 Order for interlocutory appeal.

I. *Motion for Reconsideration*

Civil Rule 6.3 of this Court requires that a motion for reconsideration be accompanied by "a memorandum setting forth concisely the matters or controlling decisions which counsel believes the court has overlooked."

Plaintiffs' letter brief in support of their motion for reconsideration is well organized and lucidly written. It shares those characteristics with all the briefs of counsel for the parties that have been submitted on this taxing question. What Plaintiffs' brief does not do is identify controlling decisions that this Court overlooked in its March 31 Opinion. Plaintiffs can scarcely be faulted for that omission, since it is common ground that no prior court decision (controlling

or otherwise) squarely addresses the § 507(b) question presented. Nor does Plaintiffs' present brief identify factual matters requiring a different result that the Court overlooked. The present motion reasserts arguments made in prior briefs which I found unpersuasive, whether or not the March 31 Opinion discussed them all with particularity. Local Rule 6.3 "is to be narrowly construed and strictly applied so as to avoid repetitive arguments on issues that have been fully considered by the court." *Wishner v. Continental Airlines*, 1997 WL 615401 (S.D.N.Y. 1997) at *1.

Accordingly, Plaintiffs' motion for reconsideration is denied.

II. *Certification for Interlocutory Appeal*

28 U.S.C. § 1292(b) provides in part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order.

I conclude without difficulty that this Court's March 31 Order meets those criteria. Indeed, this is a paradigmatic case for application of the judicial efficiency-enhancing purpose that underlies § 1292(b).

That truth is revealed by the history of the litigation. Plaintiffs' principal—or, Defendants say, their *only* claim—is that the Defendant Trustees delayed imprudently before making a lift stay/adequate protection motion, resulting in economic loss by the Plaintiff Bondholders. Central to that claim is the question of whether the bankruptcy court's denial of any relief, followed by erosion of the collateral's value, would have conferred superpriority status upon the Plaintiffs' claims (as they contend) or not (as Defendants contend).

On appeal following the first trial and its judgment in favor of Defendants, the Court of Appeals held that Judge Mukasey's jury instruction erred "because it required the jury to decide the legal question whether the Motion, if promptly filed and denied, would have resulted in superpriority status for the Bondholders' claims." 173 F.3d at 466. The Court of Appeals reasoned that "[b]y posing the superpriority issue as a question to the jury, the court improperly invited the jury to decide itself an issue of law that turns on the proper construction of § 507(b)." *Id.* at 468. The court concluded: "On remand, the district court should therefore decide the issue and determine what type of charge on superpriority and causation is appropriate in light of any factual disputes remaining in the new trial." *Id.* (footnote omitted).

In a footnote discussing the law of the case doctrine, the Second Circuit recognized the practical inevitability of its own consideration of the superpriority issue. *See* 173 F.3d at 467 n. 12: "Moreover, even if under the law of the case doctrine and the circumstances of this case, the district court was required to give an instruction that conformed to its prior ruling, we would still need to review the superpriority

instruction *de novo.*" While the Court of Appeals refrained from reaching the issue following the first trial because "it has not been adequately briefed and argued before this Court," *id.* at 468, it observed that "the parties can address the merits of the district court's legal ruling in post-verdict motions to the district court and in a second appeal to this Court, if one is filed." *Id.* at 469. The question within the § 1292(b) context is whether the Court of Appeals' review of the superpriority issue at this stage of the litigation furthers the purposes of the statute.

There is, of course, no doubt that the § 507(b) issue presents a question of law "as to which there is a substantial ground for difference of opinion," one of the three § 1292(b) criteria. As I noted in the March 31 Opinion, the First Circuit has characterized § 507(b) and its related sections as creating "a complex maze of ambiguous statutory provisions and opaque, inconsistent case law." 2000 WL 343891 at *3 (citing and quoting *Baybank-Middlesex v. Ralar Distributors, Inc,* 69 F.3d 1200, 1204 (1st Cir. 1995)). Judge Mukasey, a judge of great ability, said of the precise issue presented that there were few subjects in his judicial experience "in which I have as little confidence as I have in either of the expressions about superpriority at this point." *Id.* at *11 n. 4 (quoting the trial transcript at 950). A district court's lack of confidence in its conclusion may arise from the absence of any binding authority on point, which is the situation here.

§ 1292(b) also requires that the certified question of law be "controlling." "Controlling" does not mean "dispositive." As the Ninth Circuit has said, "[c]ourts have refused to interpret the phrase so narrowly as to require that reversal of

the district court's order terminate the litigation. . . . Rather, all that must be shown in order for a question to be 'controlling' is that resolution of the issue on appeal could *materially affect* the outcome of litigation in the district court." *In re Cement Antiturst Litigation,* 673 F.2d 1020, 1026 (9th Cir. 1982) (citation omitted; emphasis added), *aff'd.,* 459 U.S. 1190 (1983). The Second Circuit has recently accepted § 1292(b) certifications of questions of law having that more limited effect. *See In re Air Crash off Long Island, New York, on July 17, 1996,* 2000 WL 329022 (2nd Cir., March 29, 2000) (construing applicability of the Death on the High Seas Act and its limitations on recoverable damages to pending claims arising out of crash of TWA Flight 800 eight nautical miles south of the shore of Long Island, N.Y.) (affirming the district court); *In re U.S. Lines, Inc.,* 197 F.3d 631 (2d Cir. 1999) (holding that claims for declaration of insurance coverage were "core" claims in bankruptcy, and bankruptcy court's refusal to refer proceeding to arbitration was not an abuse of discretion) (reversing the district court).

Just as in *Air Crash* and *U.S. Lines,* the Court of Appeals' resolution of the certified question of law construing § 507(b) of the Bankruptcy Code would "materially affect" the outcome of the litigation in the district court. If in the Court of Appeals' view I correctly concluded that the stated circumstances would not confer superpriority status upon the Plaintiffs' claims, then their prospects on the retrial of proving (a) imprudence on the part of the Defendant Trustees that is (b) causally related to the Plaintiffs' losses are both rendered materially more difficult.

Appendix B

On the other hand, if the Court of Appeals, reversing my opinion, holds that an earlier motion by the Defendants would have guaranteed superpriority status for the Plaintiffs even if denied, then Plaintiffs' prospects on the imprudence element are materially improved. Moreover, a finding in their favor on causation becomes virtually assured, given the concessions of counsel for the Defendants at the *in limine* hearing on April 14, 2000. *See* Remarks of counsel for First Fidelity Bank: "As the circuit court said, you only need a dollar. We acknowledge that there would have been some money in the estate available for a § 507(b) claim. . . . There is no question there would have been some money in the estate. . . . As I just stated, had he gotten superpriority, there would have been some money in the estate, assuming under § 507(b) he would have been entitled to it, to pay that claim." Tr. 20-21. *See also* Remarks of counsel for United Jersey Bank and National Westminster Bank, N.J.: "You can instruct the jury, as far as we are concerned, that there would have been, if a superpriority had been granted, there would have been some money available to satisfy the superpriority. How much is not before this jury. But there would have been some money. I think that disposes of the whole issue of the fact of damage." Tr. 21.[1]

These circumstances also make it clear that an appellate decision on the superpriority question at this time will

1. These remarks of counsel reflect the fact that in a separate opinion dated April 11, 2000, I directed that the retrial be bifurcated between liability and damages issues. Plaintiffs would satisfy the causation element of liability by showing that some damage resulted from Defendants' imprudence. The precise quantum of damages would be tried in the damages phase.

"materially advance the ultimate termination of the litigation," the third § 1292(b) criterion. There is a great deal of money at stake in this case, and (absent settlement, of which there is no present indication) one may reasonably anticipate the exhaustion of all available appeals. The liability phase of the case has already been tried once.[2] It must be tried a second time because the trial judge did not decide the superpriority question. I have now decided that question. If the parties are subjected to a full plenary trial and on appeal the Second Circuit concludes that I decided that question incorrectly, then there will have to be a third trial. The superpriority question can be presented to the Court of Appeals with a minimum of effort and expense, on briefs that are for all practical purposes already written. It is a single, discrete question which will not require the Court of Appeals to master a complicated evidentiary record.

All these circumstances make it apparent, at least to this writer, that certification of this Court's March 31 Order for interlocutory appeal is not only appropriate under § 1292(b), it is highly desirable.

The Defendants oppose the certification. I have considered their arguments and am not persuaded by them. Only two require comment.

Counsel for United Jersey Bank and National Westminster Bank contend in their letter brief dated April 17, 2000 at 1 that "Judge Mukasey expressly considered and rejected a certification of this very same issue."

2. Judge Mukasey bifurcated the first trial, which ended in a verdict for the Defendants.

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Judge Mukasey's quoted comments, upon which these Defendants rely, were uttered on March 4, 1998, before the first trial and perforce before the appeal. Judge Mukasey had not rendered a formal opinion on the superpriority question, and, as noted in my March 31 Opinion at *11 n.4, changed his mind on the question throughout the first trial process. It is the Second Circuit's subsequent opinion, and the procedural posture of the litigation in the wake of that opinion, that bring my formal March 31 Opinion within the ambit of § 1292(b).

Counsel for these same defendants argue in their April 18, 2000 letter brief at 1 that Plaintiffs are precluded from making a § 1292(b) certification motion by words their counsel included in a brief dated April 17, 2000 and which Defendants' counsel quote in part. The quoted words, preceded by an ellipsis, are taken from Plaintiffs' brief *in support* of their certification motion. The full sentence in question reads: "Although the March 31, 2000 Order is dispositive with respect to plaintiffs' theory that a superpriority claim would be available regardless of the outcome of a lift stay/adequate protection motion, *the ruling is not dispositive of the action.*" Defendants' counsel quoted only the emphasized words.

Plaintiffs' counsel acknowledge, as they must, that the March 31 Order, if not overturned, is fatal to a contention that lies at the heart of their case. It is precisely for that reason that they seek a § 1292(b) certification, and the cases cited *supra* show that a question of law need not be dispositive to be "controlling" for § 1292(b) purposes. To be sure, as Defendants' brief observes in its continuing quotation,

Plaintiffs asserted that they had additional claims, including "a § 507(a)(1) administrative expense claim." But these Defendants' reference to such a claim in an effort to shore up their opposition to certification of this Court's § 507(b) decision has a hollow ring. Counsel for First Fidelity Bank contend that Plaintiffs have no viable § 507(a) claim because the complaint "cannot be read as alleging any independent failure to request a first priority administrative expense claim for collateral deficiency," and that "Plaintiffs should not be permitted to try an issue that was not pled, raised or otherwise addressed prior to trial." Brief at 4. Presumably the other Defendants make the same contention. I do not decide that issue now. It is sufficient to say that, in the § 1292(b) context, Defendants cannot have it both ways.

For the foregoing reasons, I certify the March 31, 2000 Opinion and Order for interlocutory appeal under 28 U.S.C. § 1292(b).

It is SO ORDERED.

Dated: New York, New York
April 18, 2000

s/ Charles S. Haight, Jr.
CHARLES S. HAIGHT, JR.
SENIOR UNITED STATES DISTRICT JUDGE

APPENDIX C — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AND FILED MARCH 31, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 92 Civ. 7584 (CSH)

LNC INVESTMENTS, INC. and CHARTER NATIONAL LIFE INSURANCE CO.,

Plaintiffs,

-against-

FIRST FIDELITY BANK, NATIONAL ASSOCIATION, NEW JERSEY, UNITED JERSEY BANK, AND NATIONAL WESTMINSTER BANK, N.J.,

Defendants.

* * *

HAIGHT, Senior United States District Judge.

This case, in which plaintiffs, holders of bonds issued by a trust administered by defendants, allege claims under the Trust Indenture Act ("TIA"), 15 U.S.C. § 77aaa *et seq.*, and state law, is now before this Court on remand for a new trial following the Court of Appeals' reversal[1] of a judgment

1. *LNC Investments, Inc. v. First Fidelity Bank, N.A. New Jersey,* 173 F.3d 454 (2d Cir.1999).

dismissing the complaint following a jury verdict in defendants' favor on the issue of liability in a bifurcated trial.[2] The Court of Appeals held that this Court's charge erroneously required the jury to decide a question of law arising out of the United States Bankruptcy Code ("the Code"), specifically, whether on a proper construction of the Code a secured creditor's claim is entitled to "superpriority" status if the creditor files a motion with the bankruptcy court for an order lifting the stay of proceedings against the debtor or, in the alternative, for an order of adequate protection, the bankruptcy court denies any relief, and the creditor's collateral subsequently proves inadequate to cover its claim.

This opinion answers that question.

I.

Familiarity with the Court of Appeals' opinion and the prior opinions of this Court cited at 173 F.3d at 459 n.4 is assumed. It is sufficient for present purposes to say that plaintiffs owned bonds that were issued by an equipment trust ("the Trust") created as part of a secured financing for Eastern Airlines ("Eastern"). The defendants were the indenture trustees. Following the trail blazed by the earlier opinions, I will refer to plaintiffs as "the Bondholders" and defendants as "the Trustees."

On November 15, 1986, Eastern entered into a sale/leaseback transaction covering 110 of its used aircraft. That transaction created the Trust. Eastern sold the aircraft

2. The trial took place before Judge Mukasey. Subsequently the case was reassigned to me.

to the Trust, which leased them back to Eastern. To raise the funds to purchase the aircraft, the Trust issued three series of equipment trust certificates ("Bonds"). These are the Bonds that the Bondholders bought. The three series of Bonds, whose interest rates and maturity dates differed, had a total principal value of $500,000,000. The Trust indenture obligated Eastern to make lease payments to the Trust in amounts sufficient to pay the principal and the interest due on the Bonds. Title to the aircraft was held in trust as collateral for the Bonds.

On March 9, 1989, while still possessing and making use of the collateral aircraft to conduct its business, Eastern filed a voluntary petition in the Bankruptcy Court for this District seeking protection under Chapter 11 of the Code, 11 U.S.C. § 1101 *et seq.* As of the date of the petition, there were 104 aircraft in the "collateral pool," with an appraised principal value of $681,800,000. The aggregate value of the outstanding Bonds was $453,765,000. Accordingly the Bondholders were at that time oversecured to the extent of the difference between those amounts, namely, $228,035,000, an amount referred to in bankruptcy parlance as an "equity cushion."

Over the course of the ensuing months, as the result of factors I need not describe, the market value of the aircraft decreased significantly. "As of November 9, 1990," the Court of Appeals observed, "the appraised value of the 67 aircraft remaining in the collateral pool, together with the funds set aside in a 'cash collateral account' from the sales and leases of aircraft formerly in the collateral pool, totaled somewhere between $475,443,000 and $589,679,000." 173 F.3d at 458.

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The aggregate value of the outstanding Bonds at that time is not stated in the prior opinions, but the Trustees were sufficiently alarmed by the eroding collateral to file a motion in the Bankruptcy Court (Lifland, *J.*) on November 14, 1990, for adequate protection under § 363(e) of the Code, 11 U.S.C. § 363(e). That section requires a bankruptcy court to prohibit or condition a bankrupt party's use, sale or lease of property serving as collateral if such action is "necessary to provide adequate protection" of the secured creditor's interest in the collateral. Alternatively, the Trustees moved pursuant to § 362(d) of the Code, 11 U.S.C. § 362(d)(1), for an order lifting the automatic stay of proceedings against Eastern imposed by § 362(a), which had been in effect since filing of the Chapter 11 petition and prevented the Trustees' foreclosing on the collateral. That application for relief, which together with the Court of Appeals I will occasionally refer to as "the Lift Stay/Adequate Protection Motion" or "the Motion," was pending undetermined before Bankruptcy Judge Lifland when, on January 18, 1991, Eastern ceased all operations and stipulated to the return of the remaining collateral (aircraft and cash) to the Trustee.

The Bondholders claim that these unhappy events left them in the unenviable position of general unsecured claimants against Eastern for unpaid principal amounts, and, because the value of the assets in the Eastern estate was not enough to pay even all the administrative claims, the second and third Bondholders will receive nothing. Confronted with that substantial economic loss, the Bondholders brought this action against the Trustees for breach of their duty to discharge their fiduciary responsibilities in a prudent manner. The Bondholders' principal criticism of the Trustees is that

they waited too long before making a Lift Stay/Adequate Protection Motion.

Even if one assumes an imprudent delay by the Trustees in making the Motion (which for all practical purposes might not have been made at all), the Trustees are not liable to the Bondholders unless the Bondholders can show that failure to make the Motion caused them damage. The Bondholders undertake to make that showing by contending that if the Trustees had made the Motion and the bankruptcy court denied it, the Bondholders' claims would have qualified for "superpriority" status under § 507(b) of the Code.[3] Whether the Bondholders are right (the Trustees say they are not) is central to the Bondholders' effort to demonstrate that they were damaged by the Trustees' inaction. It is also the question of law identified by the Court of Appeals to be decided by this Court on remand and in advance of the second trial.

"Superpriority" is not a word that appears in the Code. It has been fashioned by courts and commentators to describe

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3. If a Lift Stay/Adequate Protection Motion had been made by the Trustees, granted by the bankruptcy court, and the stay lifted or adequate security provided in response to that court's order, presumably the instant action would not have been filed. If the bankruptcy court had made an order for adequate protection and the mandated protection ultimately proved inadequate, it is common ground that the Bondholders' claims would have qualified for "superpriority" status under § 507(b) of the Bankruptcy Code, whose provisions lie at the heart of the case and are quoted and discussed in text. What the parties dispute, and this opinion addresses, is the legal consequence within the § 507(b) context of a bankruptcy court's denial of such a motion.

the enhanced status conferred upon a secured claim in the distribution of a bankrupt estate if the claim qualifies for § 507(b) treatment. A secured claim meeting § 507(b)'s prerequisites takes on the enviable nature of an administrative claim under § 507(a)(1), the highest priority the Code recognizes; moreover, § 507(b) provides that a qualifying secured claim "shall have priority over every other claim" allowable under § 507(a)(1). Hence the entirely appropriate adjective "*super*priority": in the privileged world of administrative claims, the § 507(b)-annointed secured claim is *primus inter pares.*

The provisions of § 507(b) and those of related sections of the Code, examined in detail in Part II *infra,* have created "a complex maze of ambiguous statutory provisions and opaque, inconsistent case law." *Baybank-Middlesex v. Ralar Distributors, Inc.*, 69 F.3d 1200, 1204 (1st Cir. 1995). I entirely agree with the First Circuit's forceful criticisms of § 507(b) and the courts' efforts to explicate the statutory scheme at whose center § 507(b) lies. In *Baybank-Middlesex* the First Circuit perceived a circumstance permitting it to "decline the invitation to enter the labyrinth ourselves, believing that we need go no further than its threshold." *Id.* I do not have that option. The Court of Appeals commands me to cross that threshold; and so, in what follows, I enter the labyrinth, hoping to avoid being devoured by the Minotaur of Error waiting at its center.[4]

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4. The Bondholders argued in their brief to this Court, although not at oral argument, that Judge Mukasey had resolved the superpriority issue this opinion addresses in their favor, and they were entitled to invoke the law of the case doctrine. If I accepted

(Cont'd)

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(Cont'd)
that proposition it would have saved me considerable effort, but I do not accept it.

In its opinion in this case, the Court of Appeals noted that the law of the case doctrine "is, at best, a discretionary doctrine, which does not constitute a limitation on the court's power but merely expresses a general reluctance, absent good cause, to reopen rulings that the parties have relied upon." 173 F.3d at 467 n. 12 (citation and internal quotation marks omitted). I think that if the judge whose prior ruling is cited as the law of the case subsequently expresses doubt that the ruling was sound, good cause exists for a successor judge to consider the matter *de novo*.

That is the situation here. In an pretrial opinion dated August 27, 1997, 1997 WL 528283, Judge Mukasey indicated that the Trustees had the "better argument" in deriving from the text of § 507(b) the proposition that an already existing equity cushion is not something "provided" and therefore cannot serve as the predicate for superpriority status should it prove inadequate. In an order dated March 2, 1998, one week before trial, Judge Mukasey reversed course and said that "upon reflection" he believed that "if a court finds adequate protection to exist, whether as the result of a pre-existing equity cushion or otherwise, and denies a lift stay motion on that basis, if the protection later proves inadequate, the resulting claim may be awarded superpriority status." Order at 2. However, during the trial Judge Mukasey said at side bar: "I will also finally confess to you, in the privacy of this room, that there are very few subjects on which I have ever expressed a view in which I have as little confidence as I have in either of the expressions about super priority at this point." Trial Tr. at 950. And during the charge conference, Judge Mukasey specifically declined to instruct the jury with respect to the opinion he expressed in the March 2, 1998 order. This understandably disappointed counsel for the Bondholders, who argued to Judge Mukasey that "it is the law." The judge responded: "I don't know that it is." Trial Tr. at 1183.

(Cont'd)

Appendix C

II.

A.

The Trustees contend that a bankruptcy court's denial of a motion for relief from stay or, in the alternative, for adequate protection on account of a pre-existing equity cushion does not entitle a secured creditor to a superpriority claim under § 507(b). They say that it is only when such a motion for adequate protection is granted and the additional protection conferred subsequently proves inadequate that a superpriority claim may become available.

The Bondholders contend that an order denying such a motion on the ground that the secured creditor was adequately protected by a pre-existing equity cushion triggers a superpriority administrative claim under § 507(b) if that equity cushion subsequently proves inadequate.

The parties agree that nowhere in the "opaque, inconsistent case law" generated by § 507(b) can one find a decision squarely in point. The elaborate briefs of counsel, and this Court's own research, have failed to unearth a holding by any court—Supreme, circuit, district or bankruptcy—that a bankruptcy court denial of a Trustees' Lift Stay/Adequate Protection Motion would bestow superpriority status upon the Bondholders' secured claims.

(Cont'd)

Meaning no disrespect to Chief Judge Mukasey (as he now is), I conclude in the exercise of my discretion that these shifting judicial sands provide an inadequate foundation for application of the law of the case doctrine. Accordingly I consider the question *de novo*.

Nor has any court held that the denial would not have that effect. The many cases cited by counsel state general principles or arise from arguably analogous circumstances. Counsel derive what comfort they can from such sources. But these cases are really no more than straws blowing in the wind; and occasionally counsel disagree on the direction in which the same straw is blowing. The precise question presented—superpriority *vel non* in the particular circumstances of this case—is an open one in the courts. Nor is there any legislative history which squarely addresses the issue.

One thing is clear enough: both sides cannot be right. Either the Bondholders would have obtained superpriority in the assumed circumstances or they would not. The question identified by the Court of Appeals must either be answered "Yes," as the Bondholders say, or "No," as the Trustees say. In the absence of dispositive court precedent or legislative history, I must perforce derive the correct answer from the Bankruptcy Code's several provisions with respect to secured creditors.

B.

The filing of a petition under the Bankruptcy Code shifts the tectonic plates under the feet of a debtor and its creditors. The economic terrain they inhabit will never be the same. That is because the Bankruptcy Code performs three separate but related functions. "In general, the essential applications of bankruptcy law can be classified into three basic categories: (i) debt collection, (ii) debt forgiveness, and (iii) debt adjustment, each responding to different aspects of

the basic question of what is to be done with the property, person, and obligations of an insolvent debtor." Branstad, *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law,* 55 The Business Lawyer 499, 522 (American Bar Association, February 2000). The case at bar is concerned with the third application of the Code, "debt adjustment." The concept of debt adjustment "encompasses those aspects of any bankruptcy law that serve to alter the distributional rights of creditors as a group *inter se*." *Id.* at 525. The petition at bar was filed under Chapter 11 of the Code, which "accomplishes debt adjustment by suspending the enforcement rights of creditors, providing for the recovery of preferences, and by prescribing a method whereby the value of the debtor's property may be distributed in accordance with the terms of a negotiated plan that may or may not distribute value in accordance with the parties' nonbankruptcy priorities." *Id.* at 529 (footnotes omitted throughout).

Generally speaking, there are three categories of creditors: (i) unsecured, (ii) secured, and (iii) the holders of claims for administrative expenses incurred by the estate. The relationship between the debtor on the one hand and unsecured and secured creditors on the other comes into existence prepetition. Administrative claims as the result of goods or services rendered to the debtor arise postpetition.

The prepetition creditor who has relied solely on the debtor's credit is unsecured and takes last among all creditors in the distribution of the debtor's assets.

The secured creditor, not willing to rely on the debtor's credit alone, has bargained for and received a security interest

in some portion of the debtor's property, which serves as collateral for the debtor's obligation. Prepetition, secured creditors usually have the power to take over the collateralized property if the debtor defaults. The foreclosed home, the repossessed car, are familiar and melancholy examples of the exercise of that power. In the case at bar, Eastern's fleet of aircraft served as collateral for the Trust whose Bonds the plaintiffs held.

But the filing of a bankruptcy petition, voluntary or involuntary, under any one of the several available chapters of the Code, automatically stays the secured creditor's power to foreclose upon the collateral. Thus the Code's automatic stay confers a considerable boon upon the debtor. The stay is also regarded as a source of "creditor protection," since without it creditors would race each other to achieve preferment through litigation, and "[b]ankruptcy is designed to provide an orderly procedure under which all creditors are treated equally." Historical and Statutory Notes following 11 U.S.C. § 361 (1993) (hereinafter "Notes") at 3. However, the secured creditor has no interest in that grand design. Its specific purpose in bargaining for an interest in the debtor's property was to avoid being treated equally with "all creditors." What does the Code do for a secured creditor, frozen in place as was the Trust, unable to avail itself of the security for which it had bargained?

§ 506 of the Code defines the amount of a secured creditor's allowed secured claim. In relevant part it provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest

> . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim . . .

In *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Inc.*, 484 U.S. 365, 372 (1988), the Supreme Court held that the phrase "value of such creditor's interest" in § 506(a) means "the value of the collateral." The phrase means the same when applied to secured creditors in § 361(1) and (2), to which I will shortly come.

§ 507 of the Code, captioned "Priorities," deals comprehensively with the priorities of all claims against the bankrupt estate. § 507(b) is the subsection dealing specifically with secured claims. It provides:

> If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such

> subsection shall have priority over every other claim allowable under such subsection.[5]

§ 507(b)'s reference to "a claim allowable under subsection (a)(1) of this section" is, by further cross-reference, an administrative expense allowed under section 503(b). *See* 11 U.S.C. § 507(a)(1). The relevant part of § 503(b) allows as administrative expenses "the actual, necessary costs and expenses of preserving the estate." *See* 11 U.S.C. § 503(b).

§ 507(b) reflects Congress's concern that, to the extent the section is applicable to a given case, a secured creditor have "adequate protection" for its claim. "The concept of adequate protection is derived from the fifth amendment protection of property interests as enunciated by the Supreme Court." Notes at 3 (citing *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940) and *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935)).

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5. One clarifying note should be sounded. The "trustee" referred to in § 507(b)'s opening phrase is not the sort of Trustee that the defendants are. The statutory reference is to a trustee appointed by the bankruptcy court to preside over the insolvent debtor's estate. In the case at bar, Eastern filed a voluntary petition under Chapter 11, which permitted Eastern to continue as a debtor-in-possession. Since a debtor-in-possession "shall have all the rights . . . and shall perform all the functions . . . of a trustee serving in a case under this subchapter," 11 U.S.C. § 1107(a), the opening phrase in § 507(b) should be read for the purposes of this case as: "If the debtor-in-possession, under section 362, 363, or 364 of this title, provides adequate protection . . ." That is the analysis employed by the Court of Appeals; *see* 173 at 466 n.11.

Appendix C

§ 507(b) also references §§ 362, 363 and 364 of the Code. The subsection is triggered if the debtor-in-possession "under section 362, 363, or 364 of this title" provides "adequate protection" to a secured creditor. As noted, § 362(a) stays creditors' proceedings against the debtor and its property. § 363(b)(1) authorizes a bankruptcy trustee to "use, sell, or lease, other than in the ordinary course of business, property of the estate." § 364(a) and (c) empower a trustee operating the business of the debtor to obtain unsecured or secured credit and incur unsecured or secured debt in the ordinary course of the business.

But each of these sections contains provisions under which secured creditors may invoke their interests. Thus § 362(d)(1) directs the bankruptcy court to grant relief from the stay to a party in interest "for cause, including the lack of adequate protection of an interest in property of such party in interest . . ." § 363(e) provides that on application "of an entity that has an interest in property used, sold or leased, by the trustee," the bankruptcy court "shall prohibit or condition such use, sale or lease as is necessary to provide adequate protection of such interest." § 364(d)(1)(B) provides that the bankruptcy court may "authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if . . . there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted."

§ 361, captioned "Adequate protection," complements these specific protective provisions by delineating the manners in which "adequate protection may be provided"

by the bankruptcy court in circumstances "[w]hen adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property." § 361(1) authorizes the court to require the bankruptcy trustee (or debtor-in-possession) to make a cash payment or periodic payments if application of these three sections "results in a decrease in the value of such entity's interest in such property." § 361(2) authorizes the court to grant "to such entity an additional or replacement lien" to the extent that the "stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property."

§ 361(3), cast in broader terms, empowers the bankruptcy court to grant "such other relief . . . as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." This language, added by the 1984 additions to the Bankruptcy Code, was intended "to indicate that the court may grant other forms of adequate protection, other than an administrative expense, which will result in the realization by the secured creditor of the indubitable equivalent of the creditor's interest in property." Notes following § 361 at 8.

Under the Supreme Court's holding in *Timbers*, throughout this statutory scheme the phrase "value of such creditor's interest" has the same meaning as "value of such entity's interest," and when either phrase is applied to secured creditors, it means "the value of the collateral." 484 U.S. at 372. The concept of adequate protection under § 361(3) entitles the secured creditor to the "realization" of "the indubitable equivalent" of its collateral, a result that will come to pass "not at once, but only upon completion of

the reorganization. It is then that he must be assured 'realization . . . of the indubitable equivalent of his collateral.'" *Id.* at 634.

To the extent that this statutory scheme of adequate protection for secured creditors applies to the circumstances of a given case, its purpose is summarized by the Historical and Statutory Notes following § 361 at 8-9:

> Adequate protection of an interest of an entity in property is intended to protect a creditor's allowed secured claim. To the extent the protection proves to be inadequate after the fact, the creditor is entitled to a first priority administrative expense under section 503(b).

The careful reader will note in the last quoted sentence a veiled reference to § 507(b). That subsection, added by the 1984 Acts, is summarized by the Notes following § 507(b) at 844:

> Subsection (b) provides that to the extent adequate protection of the interest of a holder of a claim proves to be inadequate, then the creditor's claim is given priority over every other allowable claim entitled to distribution under section 507(a).

III.

The Trustees contend principally that the plain language of § 507(b) precludes conferring superpriority status upon the claim of a secured creditor if that creditor makes a Lift

Stay/Adequate Protection Motion and the bankruptcy court denies it entirely, which is to say, the court refuses to lift the stay (so the collateral remains immune to suit and unavailable to the creditor), and also refuses to make an order of adequate protection, having concluded that the existing collateral adequately protects the creditor. § 507(b) is not triggered by such circumstances, the Trustees argue, even if the court was wrong, and protection the court viewed as adequate ultimately proves to be so inadequate that the secured creditor recovers nothing on its claim.

That proposition necessarily follows, the Trustees say, from § 507(b)'s introductory phrases: "If the [debtor-in-possession], under section 362, 363, or 364 of this title, provides adequate protection . . ." The verb "provides," cast in the present tense, is consistent only with protection provided after filing of the Chapter 11 petition, a temporal concept reinforced by the requirement that the protection covered by § 507(b) must be provided by "the debtor-in-possession," a status which a debtor attains only after a petition is filed. Thus, in the case at bar, Eastern became a debtor of the Trust and, derivatively, the Bondholders in 1986, upon completion of the financing arrangement which created the equity cushion. Eastern did not become a "debtor-in-possession" until 1989, when it filed its voluntary Chapter 11 petition.

Moreover, § 507(b) specifies that the debtor-in-possession provide adequate protection "under section 362, 363, or 364" of the Bankruptcy Code. "Under," in this context, may be read as synonymous with "pursuant to"; and the various mechanisms available to secured creditors for

obtaining adequate protection pursuant to [or under] §§ 362, 363 and 364, further implemented by the remedies of § 361, can only come into effect upon the filing of a bankruptcy petition.

The Bondholders respond that this literal reading of § 507(b) thwarts the Code's relevant purpose, which is to protect secured creditors. They cite, among other cases, *Holy Trinity Church v. United States,* 143 U.S. 457, 460 (1892) ("If a literal construction of the words of a statute be absurd, the act must be so construed as to avoid the absurdity. The court must restrain the words. The object designed to be reached by the act must limit and control the literal import of the terms and phrases employed.") (citation omitted). In the case at bar, the Bondholders argue that with respect to a secured creditor's ultimate loss, there is no principled difference between a bankruptcy court's ordering additional protection which later proves to be inadequate, and the court's denying that relief based upon the equally erroneous conclusion that the pre-existing protection is adequate. In both instances, the bankruptcy's court's error and the adverse consequences to the secured creditor are precisely the same.[6]

---

6. The parties' differences arise out the first prerequisite to § 507(b) superpriority status, found in the subsection's introductory phrases. There are other prerequisites. § 507(b) requires that a secured creditor's claim be "allowable under subsection (a)(1) of this section" and "arising from" conduct covered by §§ 362, 363, or 364(d). The Bondholders' claims satisfy these conditions. § 507(a)(1) cross-references § 503(b), which provides that administrative expenses include the "actual, necessary costs and expenses of preserving the estate." The use of collateral to keep a business operating qualifies

(Cont'd)

Each party makes the point that if Congress intended § 507(b) to mean what the other party says it means, Congress would have used language saying so explicitly. Both parties correctly argue that Congress could have expressed itself more clearly, but the arguments cancel each other out, and I am left to deal with the Delphic aspects of the words Congress actually used.

I think that both parties advance reasonable interpretations of an ambiguous statute. One aspect of the case is clear enough: both parties cannot be right. Therefore I must choose between irreconcilable statutory constructions, each having a surface plausibility.

In *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988), the Supreme Court gave some general guidance for the resolution of such questions. *Timbers* involved the proper interpretation of § 362(d)(1) of the Bankruptcy Code in a case where both parties offered contradictory but reasonable meanings. Justice Scalia wrote for a unanimous Court:

(Cont'd)
as an administrative expense. *See In re J.F.K. Acquisitions Group*, 166 B.R. 207, 212 (Bankr.E.D.N.Y.1994) ("Since the Debtor's use of the Hotel and its proceeds went to maintain the property and operate the business, it was an essential aspect of its efforts to reorganize. The use of the collateral was an actual and necessary cost of preserving the estate. Therefore, the claim of Americana is allowable as an administrative claim under Section 503(b)"). One cannot imagine a more "essential aspect" of an airline's efforts to reorganize than the use of its aircraft. Moreover, the Bondholders' claims arise from the automatic stay imposed by § 362(a)(1), which prevented the Trustee from foreclosing on the collateralized aircraft.

> Statutory construction, however, is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear, or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

484 U.S. at 371 (citations omitted).

Applying those interpretive aids to the case at bar, I conclude that the Trustees' interpretation of § 507(b) is the better one.

While the Bondholders' reading of the subsection is permissible, it requires considerable stretching of the language. The Trust's equity cushion came into being as part of the original financing transaction, when everyone's hopes were high and Eastern's horizon free of the gathering clouds of bankruptcy. It is a stretch to read § 507(b)'s reference to a "debtor-in-possession" as including an entity that became a "debtor" by means of the underlying transaction, at a time when becoming a "debtor-in-possession" was the last thing anyone wanted.

It is equally a stretch to read § 507(b)'s use of the *present tense* verb "provides" as including a bankruptcy court's order denying an adequate protection motion on the ground that *in the past*, that is to say prepetition, a debtor had provided collateral ostensibly sufficient to secure the claim of the moving creditor.

Of course, the court's order occurs postpetition, but that does not carry the Bondholders far enough. They must argue that for purposes of qualifying for superpriority status under § 507(b), a court's order *denying* adequate protection is the functional equivalent of a debtor-in-possession's *providing* that protection in response to a court order granting it. The semantic obstacles to that interpretation are apparent.

Accordingly there is considerable force to the Trustees' "plain meaning" argument, which if accepted would dispose of the issue, even if one sympathized with the Bondholders' plight, condemned the Trustees' sloth, and discerned no principled difference for superpriority purposes between orders granting and denying adequate protection. *See In re Flagstaff Foodservice Corp.*, 739 F.2d 73, 75 (2d Cir. 1984) ("Where, as here, the statutory language clearly expresses the congressional intent, a court may not read another meaning into the statute in order to arrive at a result which the court deems preferable") (construing §§ 330, 331, 364(c)(1), 503(b) and 507(b) of the Code, and concluding that secured creditor's interest had priority over attorneys' claim for postpetition services).

Nevertheless, § 507(b) is less than precise, and as I have said, I think that the Bondholders' interpretation is permissible. But the subsection's language inclines sufficiently in favor of the Trustees to cast upon the Bondholders the burden of demonstrating that, given the objectives of the Bankruptcy Code, the Trustees' interpretation of § 507(b) leads to an absurd result. The Bondholders do not make that showing.

Appendix C

While the Bondholders rely upon general legislative statements that § 507(b) is intended for the protection of secured creditors, some of which I have quoted *supra*, such statements cannot trump plain indications of congressional purpose derived from the statute. *See Timbers*, 484 U.S. at 380 (while the legislative history includes statements that "secured creditors should not be deprived of the benefit of their bargain," . . . "[s]uch generalizations are inadequate to overcome the plain textual indication in §§ 506 and 362(d)(2) of the Code that Congress did not wish the undersecured creditor to receive interest on his collateral during the term of the stay."). Nor can the Code be regarded as expressing the intent of Congress that secured creditors receive total, 100% ironclad protection; *see Timbers* at 379-80 ("That secured creditors do not bear one kind of reorganization cost hardly means that they bear none of them.").

I think it plain that the Bankruptcy Code has a number of particular objectives, which is hardly surprising for a statutory scheme that, in Branstad's phrase, undertakes to answer "the basic question of what is to be done with the property, person, and obligations of an insolvent debtor." The desires and purposes of debtors and creditors are inherently in conflict, as are the desires and purposes of creditors *inter se* (secured versus unsecured). The Bankruptcy Code necessarily embodies compromises between competing economic interests.

In the context of a Chapter 11 reorganization, a primary objective of the Code is the rehabilitation of the debtor. Congress's purpose in enacting Chapter 11 was "to establish

a preference for reorganizations, where they are legally feasible and economically practical." *In re Baker & Drake, Inc.*, 35 F.3d 1348, 1354 (9th Cir. 1994). "The object of Chapter 11 of the Code is to permit a potentially viable debtor to restructure and emerge from bankruptcy protection." *In re Kings Terrace Nursing Home and Health Related Facility,* 184 B.R. 200, 203 (S.D.N.Y. 1995). For obvious reasons, Congress prefers the successful reorganization of a corporate debtor to liquidation, dismemberment and death under Chapter 7.

Since a reorganization must be "economically practical" to succeed, it is at once apparent that a superpriority claim is the natural enemy of a reorganization. The superpriority claim is preferred even among administrative expenses, and must accordingly be a matter of concern to those whose postpetition dealings with a debtor-in-possession may be essential to the debtor's economic survival. *See In re Flagstaff Foodservice Corp.*, 739 F.2d at 75 ("Under the law as it presently exists, knowledgeable bankruptcy attorneys must be aware that the priority ordinarily given to administrative expenses may prove illusive in light of the various provisions in the code for competing or super-priorities.") (citation and internal quotation marks omitted). Thus the overhanging, intimidating presence of a multi-million dollar superpriority claim may chill the willingness of others to do business with a debtor-in-possession, dooming that resolution preferred by Congress, a successful reorganization, and leading to liquidation.

These practical concerns resound in the case at bar because the Bondholders argue for the broadest conceivable

superpriority for an oversecured creditor sitting on an equity cushion when a bankruptcy petition is filed. The Bondholders say that all a secured creditor need do to achieve superpriority status is to make a Lift Stay/Adequate Protection Motion. Superpriority is then guaranteed, whether the bankruptcy court grants relief or denies it. Opening to the jury at the first trial, counsel for the Bondholders likened their situation to that of the assureds under an insurance policy:

> Super priority is like an insurance policy. It's designed so that if the unexpected happens, you get protected. But, just like an insurance policy, you have got to pay a premium. You have got to do something. You have got to sign up for it.
>
> Well, the way you sign up for a super priority claim is very simple. It doesn't cost you money. All it requires is you raise your hand and ask. You go into bankruptcy court and you make a motion. You say to the judge, I'm not protected, please protect me. And once you start that process rolling, the please-protect-me process, if things go wrong, you get the super priority. . . .
>
> And even if he denies your adequate protection motion, you get your priority claim if it turns out you are not going to get paid in full, because implicit in that denial is a determination by the judge that, I'm denying it because you are adequately protected. If he wasn't making that

> implicit determination, he has got to grant your motion.

Trial Tr. 139-141.

The analogy to an insurance policy is not entirely apt, since if the equity cushion disappears and the security proves to be inadequate, the superpriority-brandishing secured creditor is paid not by an insurance company but by the debtor, to the derogation of other creditors and, quite possibly, to the debtor's hope for rehabilitation.

I do not doubt that Congress could enact a statute so favorable to oversecured creditors, but I do not think that it has done so in the present Code. I think that the Code protects secured creditors up to a point, but not beyond, and the point of demarcation is reached when granting superpriority status would imperil other identifiable objectives of the Code, which include a preference for economically feasible reorganizations.

The limited nature of the benefit conferred upon secured creditors by § 507(b) is inherent in its reference to a debtor-in-possession who "under section 362, 363, or 364 of this title, provides adequate protection." That language conjures up the image of a debtor providing additional protection to a secured creditor in obedience to the bankruptcy court's order granting a motion brought by the creditor under one of the three designated sections. It is one thing to say that if this court-ordered, debtor-provided protection proves to be inadequate, then under § 507(b) the secured creditor "has superpriority for a claim in the amount that the debtor's

use of the collateral during the time of the stay diminished the value of the collateral, but only to the extent such diminution is in excess of the adequate protection received." *In re Blackwood Associates, L.P.*, 153 F.3d 61, 69 (2d Cir. 1998). It is quite another to say that the court's denial of any adequate protection entitles the creditor to a superpriority claim for the full diminution in the value of the collateral.[7]

I do not think that the statutory scheme tips so far in favor of secured creditors. Although no court has explicitly said so, that is the view of a leading commentator. *See* 4 Lawrence P. King, *et al., Collier on Bankruptcy* ¶ 507.12(1)(c)(ii) (15th ed. rev.1999) at 507-90-91:

> If the property in question declines in value between the time that adequate protection is provided and the time that the property is returned to the creditor, the creditor will be entitled to a section 507(b) priority for the amount of the

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7. The Bondholders cite a number of cases for the proposition that "[a]n equity cushion falls within the range of ways by which adequate protection may be provided," Bondholders' Brief at 14. *See, e.g., In re Mellor,* 734 F.2d 1396, 1400 (9th Cir. 1984) ("Although the existence of an equity cushion as a method of adequate protection is not specifically mentioned in § 361, it is the classic form of protection for a secured debt justifying the restraint of lien enforcement by a bankruptcy court."). Applying that concept, the Ninth Circuit reversed the bankruptcy court's lifting of the stay on the ground of inadequate protection. But cases like *Mellor,* which reach the unremarkable conclusion that adequate protection may take the form of an equity cushion, shed no light upon the quite different question of superpriority status under § 507(b), the issue posed by the case at bar.

> decline. It should be kept in mind, however, that the creditor is not automatically entitled to a priority for the decline in value but is so entitled only where the creditor has specifically been provided with adequate protection. If a court declines to grant relief from stay because the court determines that no cause exists or that the creditor is adequately protected by the value of the collateral or by other factors, the creditor has not been granted adequate protection. If the court believes that the value of the property is not likely to decrease in value and declines to terminate the automatic stay on that basis, there is no grant of adequate protection and a creditor should not be entitled to assert a section 507(b) claim merely because the court's belief proves to be incorrect and the property actually does decline in value.

(footnote omitted).

I reach that conclusion in the case at bar. I do so because (a) the Trustees' interpretation of § 507(b) conforms more closely to the language of that subsection and its interconnection with other provisions of the Bankruptcy Code, and (b) the Bondholders have failed to demonstrate that the Code's statutory scheme and objectives render the Trustees' interpretation an absurdity.

The Bondholders argue with considerable force that it is anomalous for the granting and denial of an adequate protection motion to have such disparate consequences, when the bankruptcy court's error in assessing adequacy and the

consequent prejudice to the secured creditor are the same. However, in view of the language Congress used and the manner in which the Code's sections cross-reference each other, that is an anomaly that the Congress must remedy.

For the foregoing reasons, the Court answers the question presented in the negative, and will so instruct the jury.[8]

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8. Counsel for the Trustees profess to find in the Supreme Court's decision in *Timbers*, 484 U.S. 365, a rationale that requires acceptance of their interpretation of § 507(b)'s superpriority provisions.

The Court granted certiorari in *Timbers* "to determine whether undersecured creditors are entitled to compensation under 11 U.S.C. § 362(d)(1) for the delay caused by the automatic stay in foreclosing on their collateral," 484 U.S. at 369, and held that "the undersecured petitioner is not entitled to interest on its collateral during the stay to assure adequate protection under 11 U.S.C. § 363(d)(1)." *Id.* at 382. At first blush, indeed at second blush, the case would seem to have little to do with the issue at bar, which considers the superpriority status under § 507(b) of an oversecured creditor with a pre-existing equity cushion, particularly since *Timbers* neither discusses superpriorities nor cites § 507(b).

Counsel for the Trustees derive from *Timbers* a holding that "the interest of the creditor that is protected under the Bankruptcy Code is the allowed secured claim," from which they say it follows that an equity cushion is not entitled to adequate protection, from which it further follows that the Trustees are reading § 507(b) correctly. Oral Argument Tr. at 55. The deficiency may be entirely mine, but I am unable to perceive how *Timbers* governs this case. I resolve the issue for the reasons stated in text.

It is SO ORDERED.

Dated: New York, New York
March 31, 2000

s/ Charles S. Haight, Jr.
Charles S. Haight, Jr.
SENIOR UNITED STATES DISTRICT JUDGE

APPENDIX D — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED AND FILED MARCH 26, 1999

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

August Term, 1998

(Argued: January 11, 1999 Decided: March 26, 1999)

Docket No. 98-7617

LNC INVESTMENTS, INC. and CHARTER NATIONAL LIFE INSURANCE COMPANY,

Plaintiffs-Appellants,

v.

FIRST FIDELITY BANK, N.A. NEW JERSEY, UNITED JERSEY BANK and NATIONAL WESTMINSTER BANK,

Defendants-Appellees.

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* * *

Before: JACOBS and SOTOMAYOR, *Circuit Judges*, and SAND,* *District Judge*.

Appeal from a judgment of the United States District Court for the Southern District of New York (Michael B.

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* The Honorable Leonard B. Sand, District Judge of the United States District Court for the Southern District of New York, sitting by designation.

Mukasey, *Judge*) dismissing plaintiffs-appellants' claims for breach of fiduciary duty, breach of contract and violation of § 315(c) of the Trust Indenture Act of 1939, 15 U.S.C. § 77*ooo*(c) (1997), based on a jury finding that defendants-appellees' failure to act in accordance with the prudent person standard did not proximately cause injury to plaintiffs. On appeal, plaintiffs contend principally that the district court's instructions to the jury relating to proximate cause were erroneous and that a new trial is therefore required.

Vacated and remanded.

* * *

SOTOMAYOR, *Circuit Judge*:

Plaintiffs-appellants LNC Investments, Inc. ("LNC") and Charter National Life Insurance Company ("Charter") (collectively, "Bondholders") appeal from a judgment of the United States District Court for the Southern District of New York (Mukasey, *J.*) dismissing their claims for breach of fiduciary duty, breach of contract and violation of § 315(c) of the Trust Indenture Act of 1939 ("TIA"), 15 U.S.C. § 77*ooo*(c) (1997), following a jury verdict in favor of defendants-appellees First Fidelity Bank, N.A. New Jersey ("First Fidelity"), United Jersey Bank and National Westminster Bank (collectively, "Trustees"). The Bondholders own bonds that were issued by a trust administered by the Trustees. The bonds were secured by aircraft that the trust purchased from Eastern Air Lines, Inc. ("Eastern") and then leased back to Eastern pursuant to a sale/leaseback transaction. In March 1989, Eastern filed for bankruptcy, while still in possession of the aircraft.

Appendix D

The Bondholders allege that as a result of the Trustees' conduct throughout Eastern's bankruptcy, they will not receive all of the principal and interest to which they are entitled under the bonds, and they seek to hold the Trustees responsible for any shortfall. Specifically, the Bondholders claim that the Trustees acted imprudently by, among other things, waiting too long to move the bankruptcy court to lift the automatic bankruptcy stay or, alternatively, to order whatever other measures were necessary, possibly including the provision of additional security, to ensure that the Bondholders' interest in the collateral aircraft was adequately protected during the bankruptcy proceeding. The Bondholders argue that if the Trustees had moved earlier to lift the stay or for adequate protection, the bankruptcy court would have either lifted the stay and released the collateral to the Trustees, in which case the Trustees could have sold the aircraft for more than the bonds' value, or denied the motion, in which case the Bondholders' claims against Eastern's estate would have received superpriority over the claims of Eastern's other creditors.

After a trial, the jury found that the Trustees breached the prudent person standard applicable under the contract, the TIA and the common law of fiduciary duty, but that their imprudence did not proximately cause injury to the Bondholders. On appeal, the Bondholders argue, among other things, that (1) the district court improperly instructed the jury that the Bondholders had to establish proximate cause, including a reliance component, to prevail on their claims; and (2) the district court should have instructed the jury that the Bondholders' claims would have received superpriority status if the Trustees had moved more quickly to lift the stay

or for adequate protection and if their motion had been denied. We hold that the general proximate cause instruction given by the district court was appropriate, but that the Bondholders are nevertheless entitled to a new trial because the reliance portion of the instruction was erroneous, as was the district court's failure to give the Bondholders' requested instruction on the applicability of New York General Obligations Law § 13-107(1). We further hold that the district court's superpriority instruction was erroneous because it required the jury to decide the legal question whether the Bondholders' claims would have qualified for superpriority status if the Trustees' motion had been made earlier and been denied.

BACKGROUND

A. *The Trust Indenture*

On November 15, 1986, Eastern entered into a sale/leaseback transaction with a secured equipment trust ("Trust") created pursuant to an equipment indenture and lease agreement ("Trust Indenture" or "Indenture") between Eastern and defendant First Fidelity, the Indenture Trustee. The transaction called for Eastern to sell 110 used aircraft to the Trust, and for the Trust, in turn, to lease the same aircraft back to Eastern. The Trust issued three series of equipment trust certificates ("Bonds"), each in different initial principal amounts and with different interest rates and maturity dates, in order to raise the funds needed to purchase the aircraft. The three series of Bonds had a total principal value of $500,000,000. Under the Trust Indenture, Eastern promised to make lease payments to the Trust in amounts sufficient to

pay the principal and the interest due on the Bonds as well as the expenses of the Trust. Title to the aircraft was to be held in trust as collateral for the Bonds. On February 13, 1987, in connection with the registration of the Bonds with the U.S. Securities and Exchange Commission, the Trust Indenture was amended to designate a separate Trustee for each series of Bonds[1] and to redesignate First Fidelity as the collateral Trustee, which held title to the aircraft.

B. *Eastern's Bankruptcy*

On March 9, 1989, while still in possession of the collateral aircraft, Eastern filed a voluntary petition in the United States Bankruptcy Court for the Southern District of New York seeking protection under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 1101 *et seq.* Eastern's bankruptcy constituted an "Event of Default" under the Indenture. *See* Trust Indenture § 7.01(g)(i)(2). Upon an Event of Default, the Trustees were to "excercise [sic] such of the rights and powers vested in [them] by [the Trust Indenture], and use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." Trust Indenture § 9.02; *see also* 15 U.S.C. § 77*ooo*(c) ("The indenture trustee shall exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and . . . use the same degree of care and skill in

1. Midlantic National Bank was designated as the first series Trustee, defendant United Jersey Bank was designated as the second series Trustee, and defendant National Westminster Bank was designated as the third series Trustee. Midlantic National Bank is not a defendant in this case.

their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs."). Eastern's bankruptcy petition therefore triggered the Trustees' obligations of prudence under the Trust Indenture and the TIA.

Eastern's bankruptcy petition also triggered the automatic stay of § 362(a) of the Bankruptcy Code, which prevented the Trustees from taking possession of the collateral aircraft. *See* 11 U.S.C. § 362(a) (1993) ("[A] petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of . . . any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate. . . ."). As of the date of Eastern's bankruptcy petition, there were 104 aircraft, with an appraised value of $681,800,000, remaining in the collateral pool, and the aggregate principal value of the outstanding Bonds was $453,765,000. The Trust was therefore oversecured by more than $228 million, or, in other words, it maintained an "equity cushion" in that amount. Over the course of the next twenty months, however, the market value of the aircraft decreased significantly as a result of various factors, including the Iraqi invasion of Kuwait in August 1990, which caused fuel prices to rise. As of November 9, 1990, the appraised value of the 67 aircraft remaining in the collateral pool, together with the funds set aside in a "cash collateral account" from the sales and leases of aircraft formerly in the collateral pool, totaled somewhere between $475,443,000 and $589,679,000.

On November 14, 1990, the Trustees filed a motion for adequate protection pursuant to § 363(e) of the Bankruptcy

Code, which requires a bankruptcy court to prohibit or condition a bankrupt party's use, sale or lease of property serving as collateral if such action is "necessary to provide adequate protection" of the creditor's interest in the collateral. *See* 11 U.S.C. § 363(e) (1993). The Trustees' motion sought protection of their interest in the collateral aircraft "in light of the rapid and constant deterioration of any equity cushion in the [c]ollateral [a]ircraft." Alternatively, the Trustees moved pursuant to § 362(d) of the Bankruptcy Code, 11 U.S.C. § 362(d)(1) (1993), for relief from the automatic stay of § 362(a) (collectively, "Lift Stay/Adequate Protection Motion" or "Motion"). Before the bankruptcy court ruled on the Motion, however, Eastern announced that it would cease operations entirely. On the same day, January 18, 1991, the Trustees and Eastern's Chapter 11 trustee executed two stipulations providing for, among other things, Eastern's release to the Trustees of the remaining aircraft in the collateral pool and the majority of the funds set aside in the cash collateral account. On January 23 and 24, 1991, the bankruptcy court approved the stipulations releasing the collateral to the Trustees.

C. *The Bondholders' Claims*

The Bondholders purchased second series and, in LNC's case, third series Bonds at various times between September 1989 and March 1994.[2] The Bondholders subsequently

2. LNC purchased second series Bonds in July and September 1990, and third series Bonds from July through September 1990 and from July 1992 through March 1994. As of December 1996, after reselling certain second series Bonds, LNC owned $1,000,000 in (Cont'd)

brought suit against the Trustees alleging that the Trustees' delay in making the Motion was imprudent and deprived them of a substantial portion of the principal and accrued interest that they were entitled to under the Bonds.[3] Had the Motion been made earlier, the Bondholders contend, one of two favorable outcomes would have resulted: (1) an order lifting the stay and permitting the Trustees to recover and sell the aircraft at a time when the aggregate commercially reasonable sale value of the aircraft was more than 150 percent of the principal amounts owed on the Bonds; or (2) an order denying the Motion on the ground that the Trust's interest in the aircraft was adequately protected, *i.e.*, by the existing equity cushion, in which case the Bondholders would have at least been entitled to superpriority distributions from Eastern's estate under § 507(b) of the Bankruptcy Code, 11 U.S.C. § 507(b) (1993), in advance of Eastern's administrative creditors. Because the Motion was made too late, they argue, their claims did not receive superpriority status, and as a result, the Bondholders were left with only

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(Cont'd)
principal amount of second series Bonds and $25,082,000 in principal amount of third series Bonds. Charter purchased second series Bonds in September 1989 and September 1990. As of December 1996, Charter owned $1,000,000 in principal amount of second series Bonds.

3. The Bondholders also alleged malpractice by two law firms retained by certain of the Trustees in connection with Eastern's bankruptcy proceeding. The district court granted summary judgment to the defendant law firms in August 1997. *See LNC Investments, Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1997 WL 528283, at *39-46 (S.D.N.Y. Aug. 27, 1997) ("*LNC V*"). The Bondholders have not challenged the dismissal of these defendants on appeal.

general unsecured claims, for which they will receive nothing from Eastern's estate. According to the Bondholders, a prompt motion to lift the stay or for adequate protection was "the only prudent course of action open to the Trustees upon the happening of an Event of Default," *see* Second Amended Complaint ¶ 28, and the Trustees' failure to make the Motion earlier constituted a breach of their fiduciary and contractual duties under the Indenture and a violation of § 315(c) of the TIA.

D. *The Trial*

In March 1998, after extensive motion practice,[4] the Bondholders' claims against the Trustees were tried in a two-week bifurcated jury trial. After closing arguments in the liability stage, the district court instructed the jury on the "prudent man" standard applicable under the Indenture, § 315 of the TIA and the common law of fiduciary duty. *See* Trust Indenture § 9.02; 15 U.S.C. § 77*ooo*(c); *In re Clark's Will*, 257 N.Y. 132, 136 (1931) ("[A] trustee is bound to employ such diligence and such prudence in the care and management [of the trust], as in general, prudent

4. This case generated five written opinions in the district court. *See LNC Investments, Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1997 WL 528283 (S.D.N.Y. Aug. 27, 1997) ("*LNC V*"); *LNC Investments, Inc. v. First Fidelity Bank*, 935 F.Supp. 1333 (S.D.N.Y. 1996) ("*LNC IV*"); *LNC Investments, Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1995 WL 231322 (S.D.N.Y. Apr. 19, 1995) ("*LNC III*"); *LNC Investments, Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1994 WL 225408 (S.D.N.Y. May 26, 1994) ("*LNC II*"); *LNC Investments, Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1994 WL 73648 (S.D.N.Y. Mar. 3, 1994) ("*LNC I*").

men of discretion and intelligence in such matters, employ in their own like affairs.") (citation and internal quotation marks omitted). The court further instructed that "[i]n order to succeed on their claims, plaintiffs must prove that the defendants' acts or omissions were not only imprudent, but were also a proximate cause of injury to them." Transcript dated March 20, 1998, at 1312. The proximate cause instruction also included a reliance component, which stated that "[i]f the plaintiffs did not rely on the defendants, then even if the defendants acted imprudently, plaintiffs have not suffered any injury as a result of the defendants' actions or inactions." *Id.* at 1313. Although the Bondholders did not object at trial to the general proximate cause instruction, they objected to the reliance portion of the charge.

The Bondholders also asked the district court to instruct the jury that their claims would have received superpriority status under § 507(b) of the Bankruptcy Code if the Trustees had promptly filed the Motion and the bankruptcy court had denied it. The district court refused to give this proposed charge, however, and instead instructed the jury that the question whether the court's denial of the Motion would have resulted in superpriority status "was not clearly resolved and . . . was the subject of disagreement among perfectly competent and diligent bankruptcy attorneys." Transcript dated March 20, 1998, at 1311. The court further instructed that the jury was "entitled to take this uncertainty in the law into account when [it] decide[d] whether the defendant banks acted as prudent persons in this case." *Id.* at 1311-12.

The jury ultimately returned a verdict finding that the Trustees had breached their duty of prudence, but that this

breach did not proximately cause injury to the Bondholders. Based on the jury's findings, the district court entered judgment dismissing the Bondholders' complaint. The district court subsequently denied the Bondholders' post-trial motion to set aside the verdict, for judgment or for a new trial, which, among other things, claimed error in the jury instructions relating to proximate cause. This appeal followed.

DISCUSSION

A. *Standard of Review*

The Bondholders' primary contentions on appeal concern the district court's instructions to the jury. "We review a district court's jury instruction *de novo*." *United States v. Masotto*, 73 F.3d 1233, 1238 (2d Cir. 1996). "A jury instruction is erroneous if it misleads the jury as to the correct legal standard or does not adequately inform the jury on the law." *Anderson v. Branen*, 17 F.3d 552, 556 (2d Cir. 1994). "An erroneous instruction requires a new trial unless the error is harmless." *Masotto*, 73 F.3d at 1238.

B. *Reliance Instruction*

The district court's proximate cause instruction included the following reliance component:

> In considering whether the plaintiffs have suffered any damages, you must determine whether the plaintiffs have proved by a preponderance of the evidence that they relied upon the defendants. If the plaintiffs did not rely on the defendants, then

> even if the defendants acted imprudently, plaintiffs have not suffered any injury as a result of the defendants' actions or inactions. Similarly, if plaintiffs knew that the defendants were taking certain actions, knew all the facts and risks associated with those actions, and had the ability to correct them but chose not to, then you may find that those actions of the defendants did not cause the plaintiffs to suffer injury.
>
> In this regard, the plaintiffs need not show that they specifically expected or anticipated that the defendants would take any particular course of action. Rather, the plaintiffs must prove that they relied on the defendants to act prudently in general under the circumstances.

Transcript dated March 20, 1998, at 1313-14. The Bondholders argue that this instruction was erroneous because it required a finding of reliance to establish causation. We agree. To whatever extent the Bondholders' knowledge of the Trustees' conduct is relevant to the Bondholders' claims, it is in relation to potential affirmative defenses and not as an element of causation, as to which the Bondholders have the burden of proof.

1. *Reliance as an Element of Causation*

The Trustees have identified no controlling authority—and we have found none—to suggest that reliance is required to establish causation in a breach of fiduciary duty or a breach

of contract case.[5] The Trustees attempt to defend the reliance charge based on *Ryder Energy Distribution Corp. v. Merrill Lynch Commodities, Inc.*, 684 F. Supp. 27 (S.D.N.Y. 1988), *aff'd*, 865 F.2d 492 (2d Cir. 1989) (per curiam), but that case is inapposite. In *Ryder*, the plaintiff buyer (REDCO) in a commodity futures contract brought suit against the seller's futures commission merchant (Merrill) when the seller (TOI) failed to deliver the heating oil that was the subject of the contract. *Id.* at 28. REDCO alleged that Merrill failed to ask TOI whether it owned and possessed the oil necessary to cover the contract before certifying the transaction to the New York Mercantile Exchange. The district court granted summary judgment to Merrill, concluding that no reasonable jury could find a causal connection between Merrill's alleged breach of duty and REDCO's loss because, "at the time REDCO determined to enter into th[e] contract with TOI, REDCO had a degree of knowledge approaching certainty that TOI did not at the time of contracting have physical possession of the quantity of oil covered by the contract." *Id.* at 35. On appeal, we affirmed the judgment of the district court and specifically expressed "agreement with the [district] court's conclusion that REDCO's causation theory was implausible." 865 F.2d at 493.

The Trustees attempt to analogize the Bondholders' knowledge of the Trustees' delay in making the Motion to

5. The Bondholders argued before the district court that "the reliance issue is something that exists for the TIA claim, but shouldn't exist for the breach of contract or the breach of fiduciary duty [claims]." Transcript dated March 19, 1998, at 1186. On appeal, the Bondholders contend that reliance is not an element of their claim under § 315(c) of the TIA. This argument was not preserved, and we do not consider it on appeal.

REDCO's knowledge that TOI neither owned nor possessed the oil to be supplied under the contract in *Ryder*. They contend that under *Ryder*, this knowledge warranted a finding that the Trustees' imprudence did not proximately cause injury to the Bondholders. *Ryder*, however, involved a different type of duty from the one owed by the Trustees in this case. In *Ryder*, Merrill's duty was to ask TOI about the oil and to report TOI's response to the Mercantile Exchange in the form of a certification. *See Ryder Energy Distribution Corp. v. Merrill Lynch Commodities Inc.*, 748 F.2d 774, 782 (2d Cir. 1984). That duty flowed to REDCO, the buyer, because "[a]lthough the primary beneficiary of the certification duty may well [have been] the market, it [was] not unreasonable to assume that the buyer . . . might rely on the seller's [merchant] performing its regulatory duties." *Id.* However, because REDCO already knew that TOI neither owned nor possessed the oil, and therefore could not have relied on Merrill's certification, Merrill's failure to inquire before certifying the transaction could not have caused REDCO any injury. *See* 684 F. Supp. at 35.

In this case, by contrast, the Trustees' duty to the Bondholders was not to certify information but to act prudently to safeguard the assets of the Trust. *See Beck v. Manufacturers Hanover Trust Co.*, 632 N.Y.S.2d 520, 528 (1st Dep't 1995) ("The trustee . . . must, as prudence dictates, exercise [his contractually conferred rights and powers] in order to secure the basic purpose of any trust indenture, the repayment of the underlying obligation."). This duty of prudence was not qualified, either in the Trust Indenture or in the common law, by the concept of reliance. If, for example, the Trustees had breached their duty by dissolving

the Trust's security interest in the collateral aircraft, the Bondholders would have suffered injury (measured by the decreased value of their Bonds) regardless of whether they were aware of the Trustees' actions or relied on the Trustees to act prudently. The reliance instruction therefore is not supportable based on *Ryder.*

The transcript of the charging conference suggests that the district court may have considered a reliance charge appropriate based on evidence that the Bondholders knew about the Trustees' alleged breaches of duty when they purchased the Bonds. *See* Transcript dated March 19, 1998, at 1186 ("[Y]ou knew very well when you bought the bonds that no motion had been made, and you went ahead and bought them anyway."). The fact that the Bondholders purchased the Bonds knowing that the Trustees had not yet moved for adequate protection or to lift the stay, however, does not preclude a finding that they were injured by the Trustees' imprudence. The New York General Obligations Law expressly permits a bondholder to sue an indenture trustee for breaches of duty that occur prior to his purchase of the bond, regardless of the bondholder's knowledge of these breaches. *See* N.Y. Gen. Oblig. § 13-107(1) (McKinney 1989) ("Unless expressly reserved in writing, a transfer of any bond shall vest in the transferee all claims or demands of the transferrer, whether or not such claims or demands are known to exist, . . . for damages against the trustee or depositary under any indenture under which such bond was issued or outstanding. . . .").

The Bondholders specifically requested a jury instruction on § 13-107(1) to counteract the reliance charge.

See Transcript dated March 19, 1998, at 1186 ("We've got to keep in mind that the [G]eneral [O]bligations [L]aw 13[-]107 puts us in the shoes of all prior owners of the bonds, and I don't know how under those circumstances, then, we can be tagged with having to rely."). We conclude that the district court erred in rejecting this request, particularly because the court admitted evidence at trial of the Bondholders' "specific knowledge relating to the value of the collateral aircraft, or whether the referenced applications [for relief from the stay and/or adequate protection] had been made by the indenture trustees." *See* Order dated March 2, 1998. Without an instruction that the Bondholders acquired all claims of the prior holders irrespective of their knowledge of such claims, the reliance charge invited the jury to find no proximate causation simply on the basis of the Bondholders' pre-purchase knowledge of the Trustees' imprudence.

We conclude that the district court's reliance instruction improperly conditioned causation on a finding of reliance. The instruction further permitted the jury, in violation of General Obligations Law § 13- 107(1), to find no proximate causation based on the Bondholders' knowledge at the time they purchased the Bonds. As such, the instruction "mis[led] the jury as to the correct legal standard" and did not "adequately inform the jury on the law." *See Anderson*, 17 F.3d at 556. Furthermore, we are far from certain that the erroneous instruction was harmless. "An error is deemed harmless if we are convinced that the error did not influence the jury's verdict." *Masotto*, 73 F.3d at 1239. The district court specifically instructed the jury that "[i]f the plaintiffs did not rely on the defendants, then even if the defendants acted imprudently, plaintiffs have not suffered any injury as

a result of the defendants' actions or inactions." Transcript dated March 20, 1998, at 1313. The jury, in turn, specifically found that the Trustees' failure to act in accordance with the prudent person standard did not proximately cause injury to the Bondholders. Given the congruence between the language of the reliance instruction and the jury's verdict, it is certainly possible, if not likely, that the reliance charge played a role in the verdict. The erroneous reliance instruction was, moreover, integral to the standard of liability because it precluded a finding of causation. "[W]here jury instructions create an erroneous impression regarding the standard of liability, it is not harmless error because it goes directly to the plaintiff's claim, and a new trial is warranted." *Hathaway v. Coughlin*, 99 F.3d 550, 554-55 (2d Cir. 1996) (citing *Hendricks v. Coughlin*, 942 F.2d 109, 113-14 (2d Cir. 1991)).

2. *Affirmative Defenses*

Although the Bondholders' knowledge or lack of reliance cannot defeat a finding of causation in this case, the Bondholders' knowledge of the Trustees' imprudence may be relevant to affirmative defenses such as waiver, estoppel or ratification. *See, e.g., Mooney v. Madden*, 597 N.Y.S.2d 775, 776 (3d Dep't 1993) (noting that if the beneficiaries of a trust ratified or consented to the trustee's conduct, "they are bound by it"). In fact, the district court denied the Trustees' request to charge the jury on ratification, acquiescence and estoppel, apparently on the ground that these defenses were subsumed within the reliance instruction. *See* Transcript dated March 19, 1998, at 1109 ("The [ratification, acquiescence and estoppel] defense[s] [are] not in this case, and there is a reliance charge.").

That ruling had the effect of misplacing the burden of proving these affirmative defenses. *See, e.g.*, 57 N.Y. Jur.2d *Estoppel, Ratification and Waiver* § 72, at 103 (1986); *id.* § 88, at 125. The reliance charge did not allocate this burden to the Trustees, but instead required the Bondholders to "prove[] by a preponderance of the evidence that they relied upon the [Trustees]." Transcript dated March 20, 1998, at 1313. We therefore cannot treat the erroneous reliance charge as the functional equivalent of an instruction on affirmative defenses.

We note, moreover, that the criteria for application of affirmative defenses such as waiver and ratification are stringent. In order to establish that the Bondholders waived their objections to the Trustees' conduct, for example, the Trustees would have to demonstrate, among other things, that the Bondholders effected a "deliberate, informed abandonment of known rights." *See* 57 N.Y. Jur.2d *Estoppel, Ratification and Waiver* § 84, at 121. Similarly, to establish that the Bondholders ratified the Trustees' conduct, the Trustees would have to prove, among other things, that the Bondholders acted "with full knowledge of all material facts relating to the transaction." *See id.* § 76, at 108. The Trustees could not carry their burden of establishing these defenses simply by proving that the Bondholders should not have purchased the Bonds knowing that the Trustees had not yet moved to lift the stay or for adequate protection. Under § 13-107(1) of the General Obligations Law, the Bondholders' purchase of the Bonds vested in them all of the prior holders' claims or demands against the Trustees, "whether or not such claims or demands [we]re known to exist." N.Y. Gen. Oblig. § 13-107(1). The Bondholders were

therefore statutorily entitled to purchase the Bonds fully aware of the Trustees' alleged breaches of duty.

Furthermore, as the district court noted, the Bondholders alleged a continuing breach of duty by the Trustees, *i.e.*, that the Trustees should have moved throughout the bankruptcy to safeguard the value of the collateral. *See LNC V*, 1997 WL 528283, at *29 ("[P]laintiffs allege a continuing breach—*i.e.*, that the Trustees should have moved throughout the bankruptcy—and could have assumed, when they purchased their certificates, that a motion for adequate protection would shortly be filed. . . . [P]laintiffs here knew only that no motion had been filed, not that that failure would cause them injury or that it would continue after their purchase."). The Bondholders' purchase of the Bonds with knowledge of the Trustees' past breaches therefore cannot by itself demonstrate that the Bondholders knew the Trustees would continue to act imprudently.

Nevertheless, the Trustees may be able to establish waiver, estoppel, ratification or similar affirmative defenses based on evidence other than or in conjunction with the Bondholders' pre-purchase knowledge of the Trustees' failure to make the Motion.[6] We leave it to the district court on remand to determine whether the Trustees have proffered sufficient evidence to sustain the presentation of any

6. To the extent, if any, the Bondholders had the legal ability to direct the trustees to act, *but see LNC V*, 1997 WL 528283, at *15 (noting on summary judgment that the Bondholders alone were never able to issue a binding instruction to the Trustees to file the Motion because they never owned a majority of the Bonds in any series), this fact may be relevant to potential affirmative defenses.

affirmative defenses to the jury, with appropriate instructions regarding the elements of each defense, burden of proof, and General Obligations Law § 13-107(1).[7]

Having decided to vacate the district court's judgment and remand for a new trial, we need not reach the other issues raised on appeal. We will, however, consider those of the Bondholders' remaining arguments that were adequately presented on appeal because they are likely to arise again on remand. *See United States v. Jean-Baptiste*, 166 F.3d 102, 110 (2d Cir. 1999) ("Although these issues are, for purposes of this appeal, mooted by our discussion above, we address them briefly in light of the likelihood that they would recur at a new trial.").

C. *General Proximate Cause Instruction*

The Bondholders contend that the district court's general jury instruction on proximate cause—*i.e.*, that the "plaintiffs

7. In holding that the Bondholders' knowledge of the Trustees' conduct is relevant, if at all, to potential affirmative defenses, as to which the Trustees have the burden of proof, and not to causation, we express no view on the district court's summary judgment ruling that the Bondholders' damages recoverable under the TIA were limited to out-of-pocket losses attributable directly to the Trustees' breach of the prudent person standard. *See LNC V*, 1997 WL 528283, at *35, *38 (holding that the Bondholders were not entitled to recover the full face value of their Bonds because the market price at the time of their purchases reflected the risk that the Bonds would not be fully redeemed, and the Bondholders could not argue that they expected full redemption). Although this ruling presumably had no impact on the trial because the liability issues were tried first, it may or may not be a factor in the new trial.

must prove that the defendants' acts or omissions were not only imprudent, but were also a proximate cause of injury to them"—was erroneous because proximate cause is not an element of liability with respect to any of their claims for relief. The Bondholders argue that the issue of causation arises only in the context of the scope of damages recoverable for breach of fiduciary duty and breach of contract.[8] Because the trial was bifurcated and the liability issues tried first, the Bondholders argue, they should not have been required to demonstrate proximate cause. We disagree.

Ordinarily, causation is required to recover damages for breach of contract. *See* E. Allan Farnsworth, Contracts § 12.1, at 841 (2d ed. 1990) ("There is, of course, a fundamental requirement, similar to that imposed in tort cases, that the breach of contract be the cause in fact of the loss, although the presence of other contributing causes may not preclude recovery."); *cf. Bausch & Lomb, Inc. v. Bressler*, 977 F.2d 720, 731 (2d Cir. 1992) ("A plaintiff seeking damages for breach of contract . . . must demonstrate that the damages were caused by and are directly traceable to the . . . breach.") (citations and internal quotation marks omitted). Under New York law,[9] in fact, "[t]he failure to prove damages is . . . fatal

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8. The Bondholders assert that their TIA claim is governed by contract principles. For purposes of this appeal, we assume, without deciding, that the Bondholders are correct on this issue.

9. The Bondholders' breach of fiduciary duty and breach of contract claims are governed by New York law. *See* Trust Indenture § 13.13 ("This Agreement and the [Bonds] . . . shall be governed by and construed in accordance with the laws of the State of New

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to [a] plaintiff's breach of contract cause of action." *Cramer v. Spada*, 610 N.Y.S.2d 662, 664 (3d Dep't 1994) (affirming dismissal of complaint).

Causation is similarly an integral element of most tort causes of action. *See* W. Page Keeton et al., Prosser and Keeton on Torts § 41, at 263 (5th ed. 1984) ("An essential element of the plaintiff's cause of action for negligence, or for that matter for any other tort, is that there be some reasonable connection between the act or omission of the defendant and the damage which the plaintiff has suffered."). We have stated, however, that breach of fiduciary duty cases "comprise a special breed of cases that often loosen normally stringent requirements of causation and damages." *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir. 1994). This is because "[a]n action for breach of fiduciary duty is a prophylactic rule intended to remove all incentive to breach—not simply to compensate for damages in the event of a breach." *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, 722 F.2d 988, 995-96 (2d Cir. 1983). In a case alleging breach of fiduciary duty by a law firm, we have thus held that the client bringing the cause of action did not have to show either "but for" or proximate causation, but only that the law firm's breach was a "substantial factor" contributing to her injury. *See Milbank*, 13 F.3d at 543; *see also ABKCO Music*, 722 F.2d at 996 (holding that once district court found that plaintiff's conduct constituted breach of fiduciary duty, court

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York. . . ."); Second Amended Complaint ¶ 45 (alleging that upon an Event of Default, and at all times thereafter, a fiduciary relationship existed between the Trustees and the Bondholders "pursuant to the terms of the Indenture and pursuant to New York common law").

was not required to find "but for" relationship between plaintiff's conduct and defendant's injury).

More recently, however, we have observed that under New York law, the level of causation required in breach of fiduciary duty and breach of contract cases depends on the type of remedy sought. *See American Fed. Group, Ltd. v. Rothenberg*, 136 F.3d 897, 907 n.7 (2d Cir. 1998). "Where . . . the remedy sought is damages to compensate for a claimant's loss, the usual damages-causation rule for tort and contract breach cases is appropriate," but "where . . . the remedy being sought is a restitutionary one to prevent the fiduciary's unjust enrichment as measured by his ill-gotten gain, the less stringent 'substantial factor' standard may be more appropriate." *Id.* at 908 n.7. Thus, where damages are sought for breach of fiduciary duty under New York law, the plaintiff must demonstrate that the defendant's conduct proximately caused injury in order to establish liability. *See R.M. Newell Co. v. Rice*, 653 N.Y.S.2d 1004, 1005 (4th Dep't 1997) (affirming grant of summary judgment dismissing plaintiff's breach of fiduciary duty and inducement of breach of fiduciary duty claims because, "as a matter of law, any damages sustained by plaintiff were not proximately caused by wrongful conduct on the part of defendants, an essential element of plaintiff's causes of action against defendants"). "In the absence of a causal link between [the defendant's] alleged wrongful conduct and [the] plaintiff's alleged damages, the complaint must be dismissed." *Id.* (citing *Stoeckel v. Block*, 566 N.Y.S.2d 625, 626 (1st Dep't 1991) (declining to set aside jury verdict, which found that plaintiffs had breached their fiduciary duty to defendant but awarded no damages ~~on~~ defendant's

counterclaim, because "it was not demonstrated that [defendant's loss] was attributable to plaintiffs' alleged wrongful conduct")).

In this lawsuit, the Bondholders seek only damages to compensate them for injuries allegedly sustained as a result of the Trustees' imprudence. *See* Second Amended Complaint ¶¶ 39, 43, 47, A-F. The district court's proximate cause charge was therefore appropriate. *See American Fed. Group*, 136 F.3d at 907 n.7 ("In this case, the remedy being sought is compensatory damages measured by the claimant's loss, so that the appropriate injury causation standard, whether the remedy is sought for violation of fiduciary duty or breach of covenant, is the more stringent one.").[10]

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10. The Bondholders contend that even if the proximate cause instruction was appropriate, the district court should have instructed the jury not to consider the Iraqi invasion of Kuwait, which took place in August 1990 and undisputedly caused fuel prices to rise, on the issue of proximate cause. Although the district court addressed this issue on summary judgment, *see LNC V*, 1997 WL 528283, at *31, it is not clear that the court decided the issue as a matter of law. The court may have ruled more narrowly that the Bondholders raised a genuine issue of material fact as to causation and that summary judgment to the Trustees was thus inappropriate. In any event, we believe the district court properly left this issue to the jury with instructions on the law of foreseeability. *See* Transcript dated March 20, 1998, at 1312-13 ("[I]n order to find that the defendants' actions or inactions were the proximate cause of harm to the plaintiffs, you must find that the risk reasonably could have been foreseen by the defendants. In this respect, it is not necessary to find that the precise event that caused the plaintiffs' injury was foreseeable, but it is necessary to find that the event was one of a class of risks that was foreseeable.").

Appendix D

D. *Superpriority Instruction*

The Bondholders asked the district court to instruct the jury that if the Trustees had made the Lift Stay/Adequate Protection Motion sooner and the Motion had been denied, the Bondholders' claims would have received superpriority status under § 507(b) of the Bankruptcy Code.[11] The district court denied this request and instead instructed the jury that "at the time of the events giving rise to this lawsuit, that question of law was not clearly resolved and . . . was the subject of disagreement among perfectly competent and diligent bankruptcy attorneys." Transcript dated March 20, 1998, at 1311. The court also told the jury that it was "entitled to take this uncertainty in the law into account when [it] decide[d] whether the defendant banks acted as prudent persons in this case." *Id.* at 1311-12.

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11. Section 507(b) provides:

> If the trustee [or the debtor-in-possession] . . . provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim . . . arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

11 U.S.C. § 507(b) (1993); *see also* 11 U.S.C. § 1107(a) (1993) ("[A] debtor-in-possession shall have all the rights . . . and shall perform all the functions and duties . . . of a trustee serving in acase under this subchapter.").

On appeal, the Bondholders argue that this instruction was erroneous because it required the jury to decide the legal question whether the Motion, if promptly filed and denied, would have resulted in superpriority status for the Bondholders' claims. They contend, moreover, that this error was not harmless because the outcome of the Motion was critical to the jury's determination of whether the Trustees' delay in filing caused injury to the Bondholders. Had the jury been properly instructed on the law of superpriority status, the Bondholders argue, the jury would have found that the Trustees' delay was not only imprudent but also the proximate cause of injury to the Bondholders.[12]

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12. The Bondholders also argue that under the doctrine of law of the case, they were entitled to an instruction on the law of superpriority status consistent with the district court's ruling on that issue in the Bondholders' favor one week prior to trial. *See* Order dated March 2, 1998 (noting that § 507(b) "permit[s] superpriority status when the Trustee 'provides' adequate protection that later proves insufficient," and concluding that "the sensible way to read the statute is that if a court finds adequate protection to exist, whether as the result of a pre-existing equity cushion or otherwise, and denies a lift stay motion on that basis, if the protection later proves inadequate, the resulting claim may be awarded superpriority status."). However, the law of the case doctrine "is, at best, a discretionary doctrine, which does not constitute a limitation on the court's power but merely expresses a general reluctance, absent good cause, to reopen rulings that the parties have relied upon." *Tischmann v. ITT/Sheraton Corp.*, 145 F.3d 561, 564 (2d Cir. 1998) (citations and internal quotation marks omitted). Moreover, even if under the law of the case doctrine and the circumstances of this case, the district court was required to give an instruction that conformed to its prior ruling, on appeal, we would still need to review the superpriority instruction *de novo*. *See id.* at 564-65 ("[I]t makes no (Cont'd)

Appendix D

As an initial matter, we note that the Bondholders' superpriority argument only has force if the Trustees' delay in making the Motion was the breach of duty found by the jury. This is not clear from the verdict form, which did not ask the jury to specify the factual basis for any finding of imprudence.[13] Although the Bondholders argue that any other breaches of duty by the Trustees were only relevant to the extent they impacted the Trustees' ability to make the Motion, the complaint alleges numerous other breaches of duty by the Trustees, many of which were argued at trial. *See* Second Amended Complaint ¶ 37 (alleging that the Trustees "negligently failed to use the same degree of care and skill as a prudent man, in that, among other things, . . . the Trustees negligently failed to [1] heed the caveats in the March 1989 Avmark appraisal, warning of a dramatic decline in the value of the Trust aircraft in the near future; . . . [2] retain an aircraft marketing expert; . . . [3] investigate and monitor the physical condition of the Trust aircraft; . . . [4] investigate and monitor the market for aircraft of the type owned by the Trust; and . . . [5] investigate the remedies available to the Trust under the Bankruptcy Code"); *id.* ¶¶ 36, 42, 46 (alleging that the Trustees breached the prudent person standard "by, *among other things*, failing to make a prompt motion") (emphasis

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(Cont'd)

difference on this appeal whether the magistrate judge acted in accord with the principle of law of the case. The issue on appeal is whether the [defendant's severance pay plan] is an ERISA plan. We would need to pass on that question *de novo* [in any event].").

13. The Verdict Form asked simply: "With respect to each of the defendants[,] . . . do you find that the defendant failed to act in accordance with the prudent man standard?"

added). At the charging conference, in fact, the Bondholders objected to the Trustees' proposal to limit the prudent person question on the verdict form to the Trustees' failure to make the Motion prior to November 1990. Thus, we cannot be certain on this record that the Trustees' delay in making the Motion was the breach of duty found by the jury. Solely for purposes of addressing the Bondholders' superpriority argument, however, we will assume that the jury's verdict was predicated on the untimeliness of the Trustees' filing.

We agree with the Bondholders that the district court's superpriority instruction was erroneous because it invited the jury to decide a legal issue. The instruction stated:

> You've heard conflicting testimony in this case about what happens if a creditor brings a lift-stay and/or adequate protection motion and the bankruptcy court decides not to lift the stay or to order additional protection because the court finds that the creditor has an equity cushion that is already sufficient to protect him. *If the court's decision not to grant adequate protection turns out to be wrong, that is, if the equity cushion declines to the point that it is not in fact sufficient to cover the creditor's claims, is the creditor entitled to superpriority status on the portion of his claims that are not covered?*
>
> I instruct you that, at the time of the events giving rise to this lawsuit, that question of law was not clearly resolved and, as you have heard, was the subject of disagreement among perfectly

> competent and diligent bankruptcy attorneys. You are entitled to take this uncertainty in the law into account when you decide whether the defendant banks acted as prudent persons in this case.

Transcript dated March 20, 1998, at 1311-12 (emphasis added).

Insofar as the jury's consideration of the unsettled state of the law was limited to the question whether the Trustees' delay in making the Motion was prudent, the charge was undoubtedly correct. However, because the instruction did not give the jury any guidance on the law of superpriority status, it left the jury without a legal context in which to decide whether the Trustees' delay, if imprudent, caused injury to the Bondholders. By posing the superpriority issue as a question to the jury, the court improperly invited the jury to decide itself an issue of law that turns on the proper construction of § 507(b). *See United States v. Nolan*, 136 F.3d 265, 271 (2d Cir.) ("[M]atter[s] of statutory interpretation and legal definition [are] properly decided by the court, which is the 'final author[ity] on issues of statutory construction.'") (quoting *Federal Election Com'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 32 (1981)) (last alteration in original), *cert. denied*, 118 S. Ct. 2307 (1998).[14] Because the superpriority instruction required

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14. It is not apparent from the record before us whether the Trustees took the position that some factor other than statutory construction would have intervened to preclude a grant of superpriority status even if the Motion had been denied. We assume in light of the parties' arguments and solely for purposes of this appeal that the issue is purely legal.

the jury to decide this legal question in order to resolve the causation issue, it failed "adequately [to] inform the jury on the law." *Anderson*, 17 F.3d at 556. On remand, the district court should therefore decide the issue and determine what type of charge on superpriority and causation is appropriate in light of any factual disputes remaining in the new trial.[15]

Because the case is being remanded for retrial, we need not and do not decide on the merits whether the requirements of § 507(b) are satisfied when a bankruptcy court denies a lift stay/adequate protection motion on the basis of adequate protection and that protection later proves inadequate. Our decision not to reach this issue on the merits is reinforced by the fact that it has not been adequately briefed and argued before this Court. As we have noted, however, while it will be entirely correct for the district court, on remand, to have a jury, appropriately instructed as to the law on superpriority status, consider whether the Trustees' delay in making the

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15. The Bondholders argue that the district court erroneously excluded certain evidence regarding the amount of funds Eastern had available to pay creditors holding superpriority claims. Whether funds existed to pay the Bondholders' superpriority claims is relevant to the question whether the Trustees' failure to make the Motion caused injury to the Bondholders. We need not reach this issue, however, because if the district court determines on remand that the Bondholders' claims would have been entitled to superpriority status had the Motion been filed earlier and been denied, it can then reconsider this evidentiary ruling, assuming the availability of funds is a disputed issue of fact. We note that even if this issue is not disputed, proximate causation would still be required with respect to the other breaches of duty alleged by the Bondholders, assuming the Bondholders continue to pursue those other breaches as part of their claims.

Lift Stay/Adequate Protection Motion was prudent, the jury should not be permitted to decide itself the legal question whether the bankruptcy court's denial of the Motion would have resulted in superpriority status by operation of § 507(b). Accordingly, if the district court decides that as a legal matter the denial of the Motion would have resulted in superpriority status for the Bondholders' claims, it should so instruct the jury and should determine by use of jury interrogatories, *see* Fed. R. Civ. P. 49(b), whether the Trustees breached their duty of prudence by failing to make the Motion earlier and, if so, what damages are specifically attributable to that failure. The jury's interrogatory answers will indicate whether the district court's charge on the legal result of the Motion had any effect on the jury's verdict. If not, the underlying legal question is mooted. Otherwise, the parties can address the merits of the district court's legal ruling in post-verdict motions to the district court and in a second appeal to this Court, if one is filed.

CONCLUSION

For the reasons stated in this opinion, the judgment of the district court is vacated and the case remanded for a new trial.

APPENDIX E — TRANSCRIPT OF DECISION OF DISTRICT JUDGE HON. MICHAEL B. MUKASEY OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AND FILED MARCH 4, 1998

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

92 Civ. 7584 (MBM)

New York, N.Y.
March 4, 1998
4:45 p.m.

LNC INVESTMENTS, INC., and CHARTER NATIONAL LIFE INSURANCE COMPANY,

Plaintiffs,

v.

FIRST FIDELITY BANK, NATIONAL ASSOCIATION, NEW JERSEY, et al.,

Defendants.

Before: HON. MICHAEL B. MUKASEY,
District Judge

* * *

Appendix E

(Case called)

THE COURT: All right. Mr. Taube, we are in open court. There is a crowd of your colleagues here. We are on the record.

MR. TAUBE: Very good, your Honor.

THE COURT: I have read the papers that were submitted to me from Mr. Taube and from Mr. Pollack in an envelope stamped, "time sensitive," which I thought might self-destruct, but when it didn't, I opened it and read it. And the ruling is as follows:

Defendants have moved the Court to reconsider a portion of the Court's order dated March 2, 1998. In that order, I held that plaintiffs would be permitted to argue at trial that the trustees breached their fiduciary duty by failing to promptly make a lift stay application to the bankruptcy court on the theory that the bankruptcy judge could have denied that motion due to the existence of adequate protection as evidenced by the then-existing equity cushion.

Plaintiffs would also be permitted to argue they would have been entitled to recover administrative expenses on a superpriority basis under Section 507 (b) of the Bankruptcy Code to the extent that the equity cushion ultimately proved, despite the bankruptcy court's finding, to be inadequate.

I am granting the application to reconsider and on reconsideration I adhere to my prior ruling, i.e., my ruling of March 2.

Appendix E

The defendants' principal argument is that the language of the statute, i.e., that the "trustee" must "provide" the adequate protection before a claim for superpriority will lie under Section 507(b), that that language forecloses plaintiffs' attempts to recover on the theory that I described above.

If I were the first court to interpret Section 507(b), then I might agree that defendants' literal reading of the language of the statute is the only sensible interpretation of when superpriority status is available to a creditor, or at least a more sensible interpretation than its alternative. However, a great deal of water and some blood has passed under the bridge since Section 507 (b) was enacted by Congress and what has happened since then must inform the present decision.

First of all, it is well-settled that despite its literal terms, Section 507(b) does not require that adequate protection be provided through a court order or subsequently be approved by a court. See *Travelers Insurance Company v. American Agcredit Corp.*, 859 F.2d 137 (10th Cir. 1988).

Of course, it is beyond cavil that when a court actually orders or approves of the provision of adequate protection to a creditor, the requirements of Section 507 (b) are satisfied.

In addition, Section 507(b) has also been held to permit the parties themselves to enter into a stipulation to provide adequate protection for the creditor even before a trustee was appointed. See *In re Airlift International, Inc.*, 761 F.2d 1503, 1512 (11th Cir. 1985). And that stipulation can serve as a predicate for a later finding that adequate protection has been provided.

Given these and other authorities, it cannot be maintained seriously that the only mechanism by which superpriority status can be obtained under Section 507 (b) is if it is the "trustee," and the trustee alone, that "provides" adequate protection that later proves inadequate.

Therefore, I have to consider the operation of section 507 (b) in relation to the function it is intended to perform in the bankruptcy system.

As several courts have noted, apart from "encouraging the provision of goods and services to the estate" post-petition, see for example *Bonapfel v. Nalley Motor Trucks* (In re Carpet Ctr. Leasing Co., Inc.) 991 F.2d 682, 685 (11th Cir. 1993), amended, rehearing en banc denied, 4 F.3d 940 (11th Cir. 1993), cert. denied, 510 U.S. 1118 (1994), Section 507 (b) has the broader objective of establishing "a statutory fail-safe system in recognition of the ultimate reality that protection previously determined . . ." by the bankruptcy court to be adequate "may later prove inadequate." *In re Marine Optical, Inc.*, 10 B.R. 893 (B.A.P.D.Mass 1981).

Another court has noted that Section 507 (b) "was intended to capture value unexpectedly lost during the course of the case." *In re Callister*, 15 B.R. 521, 528 (Bankruptcy D.Utah 1981), appeal dismissed, 673 F.2d 305 (10th Cir. 1982).

Moreover, the brief legislative history of Section 507(b), to the extent one can find it, provides that "to the extent that adequate protection of the interest of a holder of a claim

proves to be inadequate, then the creditor's claim is given priority over every other allowable claim entitled to distribution under Section 507(a)." 124 Cong.Rec.H 11,095 (Daily Edition September 28, 1978).

Given the breadth of purposes behind Section 507(b), I conclude its language, as it has been interpreted over the years, is broad enough to encompass the theory that plaintiff seeks to advance at trial here. As I have noted, courts have already held that a bankruptcy judge's order to a trustee or debtor-in-possession to provide adequate protection of the collateral is sufficient to trigger superpriority status for the creditor under Section 507(b).

It follows from that principle that a creditor ought to be entitled to the same status if the bankruptcy court denies a lift stay motion based on a finding that adequate protection was already in place due to an existing equity cushion that later proved to be inadequate, and thereby showed that the Court's determination was erroneous, or that it later proved to be inadequate because of circumstances not anticipated. In that way, superpriority status would be available to creditors in such situations and would turn, as I believe it should, on the bankruptcy judge's determination of the existence of adequate protection.

In addition to making an argument based on the language of Section 507 (b), defendants argue also that my ruling would create an incentive for secured creditors to file "boilerplate" lift stay motions in every bankruptcy proceeding so that they would be able to take advantage of superpriority status no matter what the court decides on that motion.

Defendants' argument paints with too broad a brush for several reasons.

First, the alleged expansion of Section 507(b) against which the defendants now complain would only come into play where a secured creditor was involved, a lift stay motion has been denied, and debtor's estate actually incurs administrative expenses that are subject to reimbursement under Section 503. Thus, secured creditors would not have an incentive to make boilerplate lift stay motions at the start of every bankruptcy proceeding, particularly where the secured creditors do not wish a return of the collateral, which of course is a possibility if you make a lift stay motion on the principle that you have to be careful of what you wish for, it might be granted.

Second, defendants' argument ignores the incentives that would be produced if I were to adopt their proposed reading of Section 507(b). Instead of making a boilerplate lift stay motion at the start of every proceeding, secured creditors operating under defendants' proposed regime would have an incentive to file repeated motions for adequate protection over the course of a bankruptcy proceeding should the value of the equity cushion fluctuate even to the slightest degree. The secured creditors would be filing these motions in an effort to get an order from the bankruptcy judge that adequate protection be provided such that the creditors could later take advantage of the superpriority provisions of Section 507(b).

Third, the bankruptcy court is already possessed of sufficient ammunition to combat the filing of frivolous motions of the sort envisioned above, namely, Federal Rule of Bankruptcy Procedure 9011(a), the equivalent of Rule 11

under the Federal Rules of Civil Procedures, which makes that kind of conduct subject to sanctions.

For those reasons, defendants' motion for reconsideration of my ruling of March 2, 1998, is granted and on reconsideration I adhere to my prior ruling for the reasons I just stated.

Defendants have also requested that I certify this issue to the Second Circuit. This issue fulfills none of the requirements for interlocutory certification, most particularly it will not speed the resolution of the case. What will speed the resolution of the case is the upcoming trial and that's where the case will be resolved. Accordingly, the motion for certification is denied.

Now, may I suggest that you all go back to your offices and prepare for trial rather than peppering my in box with correspondence, be it time sensitive or not.

Okay. Have a good afternoon. I did want somebody to send me a proposed description, simple description to the jury of what the case is about. That I have not seen. So if you can come up with that, that actually will be helpful.

MR. POLLACK: Your Honor received the verdict form that I sent in earlier. Is that something that you had reaction to at this point?

THE COURT: Not at this point simply because I have been too busy with your other correspondence. That wasn't marked time sensitive.

Appendix E

MR. McCARTHY: Plaintiffs will also be submitting a verdict forth.

THE COURT: Thank you, Mr. Taube.

APPENDIX F — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED AND FILED MARCH 2, 1998

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

92 Civ. 7584 (MBM)

LNC INVESTMENTS, INC., and CHARTER NATIONAL LIFE INSURANCE COMPANY,

Plaintiffs,

-against-

FIRST FIDELITY BANK, NATIONAL ASSOCIATION, NEW JERSEY, UNITED JERSEY BANK, and NATIONAL WESTMINSTER BANK, N.J.,

Defendants.

FIRST FIDELITY BANK, N.A.,

Third-Party
Plaintiff,

-against-

SHAWMUT BANK CONNECTICUT, N.A.,

Third-Party
Defendant.

Appendix F

ORDER

MICHAEL B. MUKASEY, U.S.D.J.

At a pretrial conference on February 25, 1998, the parties raised two legal issues to be resolved before trial.

The first is whether, as plaintiffs argue, a creditor can obtain superpriority status under § 507(b) of the Bankruptcy Code if a bankruptcy court denies a lift stay motion on the ground, later proved erroneous, that adequate protection exists in the form of an equity cushion, rather than as the result of some additional protection otherwise provided. I intimated in an earlier opinion, *LNC Investments. Inc. v. First Fidelity Bank*, No. 92 Civ. 7584, 1997 WL 528283, at *6, 1997 U.S. Dist. LEXIS 12858, at *17-18 (S.D.N.Y. Aug. 27, 1997), that defendants had the "better argument" when they reasoned—from the text of the statute permitting superpriority status when the trustee "provides" adequate protection that later proves insufficient—that an already existing equity cushion is not something "provided" and therefore cannot serve as the predicate for superpriority status should it prove inadequate.

However, as plaintiffs argue, that reading of the statute creates anomalous results. For example, should even an additional dollar of protection be provided on top of an existing equity cushion, a creditor's claim would receive superpriority status if both the additional protection and the preexisting cushion later proved inadequate, but would not otherwise. Upon reflection, I believe that the sensible way to read the statute is that if a court finds adequate protection

to exist, whether as the result of a pre-existing equity cushion or otherwise, and denies a lift stay motion on that basis, if the protection later proves inadequate, the resulting claim may be awarded superpriority status. This would grant superpriority status based on the court's determination, which I believe is what was intended and would promote uniformity of results among those similarly situated.

The second issue—actually, several issues—is whether defendants may prove plaintiffs' general knowledge and, sophistication, their knowledge of and belief regarding the value of the collateral aircraft, and their knowledge of applications by the indenture trustees for relief from stay and/or adequate protection. To the extent such evidence may disclose specific knowledge relating to the value of the collateral aircraft, or whether the referenced applications had been made by the indenture trustees, such evidence is admissible. *See In re Clark's Will*, 257 N.Y. 132, 138-39 (1931); *In re Pate's Estate*, 84 N.Y.S. 2d 853, 870 (Sur. Ct. N.Y. Cty. 1948), *aff'd* 277 A.D. 768, 95 N.Y.S.2d 903 (1st Dept 1950). Evidence of more general knowledge or sophistication would be far more time-consuming than probative, Fed. R. Evid. 403, and will not be admitted.

SO ORDERED:

s/ Michael B. Mukasey,
U.S. District Judge

Dated: New York, New York
March 2, 1998

APPENDIX G — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING DATED AND FILED DECEMBER 11, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ROSEANN B. MACKECHNIE
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the day of December two thousand two.

Dkt No: 00-9419

LNC Investments, Inc., et al.,

Plaintiffs-Appellants,

v

First Fidelity Bank, et al.,

Defendants-Appellees.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellants LNG Investments, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

Appendix G

It is further noted that the petition for rehearing *en banc* has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

ROSEANN B. MACKECHNIE, Clerk

By: s/ Arthur M. Heller
Arthur M. Heller
Administrative Attorney

APPENDIX H — STATUTES INVOLVED

11 U.S.C.A. § 361

§ 361. Adequate protection

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

Appendix H

11 U.S.C.A. § 362

§ 362. Automatic stay

* * *

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

* * * *

Appendix H

11 U.S.C.A. § 363

§ 363. Use, sale, or lease of property

* * *

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

* * * *

Appendix H

11 U.S.C.A. § 507

§ 507. Priorities

* * *

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

* * * *

Appendix H

15 U.S.C.A. § 77*ooo*

§ 77*ooo*. Duties and responsibility of the trustee

* * *

(c) Duties of the trustee in case of default

The indenture trustee shall exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same degree of care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.

* * * *